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Michele M. DeStefano
University of Miami School of Law, md@law.miami.edu

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Creating a Culture of Compliance: Why Departmentalization May Not Be the Answer

*Michele DeStefano**

Over the past few decades, as corporate criminal liability rules, sentencing guidelines, and settlement incentives have changed, there has been increased emphasis on and resources devoted to the compliance function at large publicly held companies. In this article, Professor DeStefano traces the development of the compliance function at large corporations and questions the recent mandate by certain governmental entities that malfeasant corporations designate a chief compliance officer and separate the compliance gatekeeping function from the legal department so that this chief compliance officer does not report to the general counsel. She categorizes the types of arguments made for and against departmentalization and then analyzes them from the perspective of the public's objectives to increase detection, monitoring, and prevention of corporate misconduct. By examining secondary literature, surveys, and interviews she conducted with 70 general counsels and chief compliance officers, she hypothesizes that preemptive departmentalization may not be in the public's best interest. It may not increase transparency into compliance transgressions at corporations, actual compliance by corporations, or the commitment by corporations to a culture of compliance and ethics. Further, such structural reorganization of the compliance function may generate consequences that offset the potential benefits of departmentalization and create a sense of false complacency that distracts from substantive cultural change that is integrated throughout the organization. Ultimately, she concludes that a focus on culture and informal norms may have more potential to meet the public's

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* Associate Professor of Law, University of Miami School of Law and Founder, LawWithoutWalls [formerly Michele DeStefano Beardslee]. Email: mdestefano@law.miami.edu. I am grateful for comments I received at the AALS 2012 Business Section session and at the recent 2013 Fordham Law Ethics Schmooze. I also thank David Abraham, Mary Coombs, Bruce Green, Sean Griffith, Hakim Lakhdar, Nicola Sharpe, Robert E. Rosen, Hendrik Schneider, Leo Staub, William H. Widen, and David B. Wilkins for their advice, input, and comments. Also, I thank Josh Brandsdorfer, Peter Cunha, and Anna Vino for their research assistance. All errors are mine.

objectives than a focus on organizational structure. Therefore, she proposes the government revise its current focus on the external manifestations of compliance to inward, cultural change. Specifically, she suggests that the government reward corporations that take an inward look at how work is actually being done within the company and at the networks and organizational culture that exists beneath the surface of the organization chart, the mission statement, and code of conduct. Such focus, she believes, could enable compliance structures and programs that promote public access to information about compliance transgressions, actual compliance by corporations, and a culture of compliance and ethics within a corporation.

I. INTRODUCTION

Over the past few decades, as corporate criminal liability rules, sentencing guidelines, and settlement incentives have changed,[1] there has been increased emphasis on and resources devoted to the compliance function at large publicly held companies.[2] What might have been thought of twenty years ago as a basic corporate governance[3] function is now being ceded to compliance departments. These compliance departments are generally in charge of monitoring and ensuring compliance with legal obligations and ethical standards

1. *See* Leonard Orland, *The Transformation of Corporate Criminal Law*, 1 BROOK. J. CORP. FIN. & COM. L. 45, 45 (2006) (tracing the "profound change" in corporate criminal law and the federal government's increase in the use of deferred prosecution or nonprosecution agreements); Christine Parker, *The Ethics of Advising on Regulatory Compliance: Autonomy or Interdependence?*, 28 J. BUS. ETHICS, 339, 339 (2000) ; Lynn Sharp Paine, *Managing for Organizational Integrity*, HARV. BUS. REV., Mar.–Apr. 1994, at 106, 109; *see infra* Part II.A. (providing a brief review of corporate criminal liability rules, sentencing guidelines, and settlement incentives that emphasize the importance of corporate compliance initiatives).

2. *See* Cristie Ford & David Hess, *Can Corporate Monitorships Improve Corporate Compliance?*, 34 J. CORP. L. 679, 694 (2009) ("Over the last few decades there has been tremendous growth in the importance of corporate compliance and ethics programs in criminal and civil liability."); *id.* at 680 (explaining that in response to corporate wrongdoing, the federal government has required corporations to create enhanced compliance programs as part of deferred prosecution or non-prosecution agreements); *cf.* Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L. Q. 487, 500–11 (2003) (reviewing the many instances in which corporate law mitigates liability based on the corporation's ability to demonstrate that it has put into place enhanced or effective internal compliance structures like conduct codes and compliance programs and contending that this legal stance is based on a belief that such internal compliance structures reduce corporate misconduct). *See also infra* Part II.

3. TOM BAKER & SEAN J. GRIFFITH, ENSURING CORPORATE MISCONDUCT: HOW LIABILITY INSURANCE UNDERMINES SHAREHOLDER LITIGATION 9 (2011) ("'Corporate governance' is a broad concept that much of the legal literature has given a narrow definition . . . . But corporate governance may refer more broadly to any system of incentives and constraints operating within a firm . . . designed to constrain bad acts on the part of corporations and their managers.").

beyond those legally required.[4] This transition, along with the current regulatory environment and corporate structure, raises questions about the compliance function in large, U.S. publicly traded corporations. What purpose does and should it serve? Should the compliance function be within or outside the purview of the legal department? Who should fill the role of chief compliance officer, to who should the chief compliance officer report, and what role should the chief compliance officer play?

Today there is little uniformity to how corporations implement their compliance function,[5] the person the organization selects to actively run compliance, or the titles of those playing compliance roles.[6] However, historically, in large publicly traded corporations,[7] issues of prevention and compliance have been within the purview of the legal department[8] and the individual in charge of compliance has

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4. Corporate compliance programs have evolved to focus on issues of compliance and ethics. *See infra* notes 92–93 and accompanying text. Generally, when this Article refers to the compliance program or function, it includes in that the ethics function as further described in Part II. Moreover, this Article focuses on the need for corporations to create a culture of compliance. This is similar to what Benjamin W. Heineman calls "a culture of integrity," which includes robust "adherence to the spirit and letter of the formal rules" (i.e., compliance), "adoption of ethical standards beyond the formal rules that bind" (i.e, ethics), and creation of an "employee population that exemplifies the fundamental values of honesty, fairness, candor, trustworthiness and reliability." Ben W. Heineman Jr., *Only the Right CEO Can Create a Culture of Integrity*, CORP. COUNS., (June 5, 2013), http:www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202603019169; *see also* BEN W. HEINEMAN JR., HIGH PERFORMANCE WITH HIGH INTEGRITY 1–2 (2008). As discussed in Part V, the ethics and values component is integral to creating a culture of compliance.

5. Paine, *supra* note 1, at 110-11 (demonstrating that some utilize an "integrity-based" approach that focuses on values and empowerment while others take a "compliance based" approach that is based on punishment for transgressions); *see also* John Hasnas, *Managing the Risks of Legal Compliance: Conflicting Demands of Law and Ethics*, 39 LOY. U. CHI. L.J. 507, 516 (2008) ("Research demonstrates that there are two distinct approaches to reducing the level of criminal activity among a firm's employees: "the command and control" approach and the "self-regulatory" approach."); Darren Sinclair, *Self-Regulation Versus Command and Control? Beyond False Dichotomies*, 19 L. & POL'Y 529 (1997) (evaluating the two approaches); Mark Suchman, *Managing Legitimacy: Strategic and Institutional Approaches*, 20 ACAD. MGMT. REV. 571 (1995) (describing the two approaches). *See infra* note 92 and accompanying text.

6. It is impossible to identify all the different variations of organization structure that exist across large publicly held corporations in the United States. For a broad overview based on trade surveys, secondary literature, and the interviews conducted in the Compliance Study, *see* Part II; *see also* Ford & Hess, *supra* note 2, at 693; *see infra* notes 56 and 121 and accompanying text.

7. This Article focuses on large publicly traded corporations.

8. Robert E. Rosen, *The Inside Counsel Movement, Professional Judgment and Organizational Representation*, 64 IND. L. J. 479, 487 (1989) [hereinafter Rosen, *Inside Counsel*] (reporting that overseeing regulation and compliance was central to the in-house lawyers role in 1989); *see also infra* note 125 and accompanying text. *See also* Boehme, *infra* note 174 (indicating that in both the banking and health care industries, the CCO was historically subordinate to the GC, although this is changing).

often reported to the general counsel[9] and sometimes has actually been the general counsel.[10] Over the past few years however, in the wake of the corporate scandals that have spanned a range of industries (including pharmaceutical, insurance, financial services, health care, consumer products),[11] there is a trend to separate the compliance function from the legal department and create independent compliance departments largely comprised of people with legal training.[12] These compliance departments are focused on monitoring compliance with the law and ethical obligations.[13]

Although regulatory bodies and governmental agencies do not require that corporations separate the compliance and legal functions, their unofficial stance appears to be that they should. Indeed, recently, the U.S. Securities and Exchange Commission ("SEC")[14] and the Department of Health and Human Services ("DHHS"),[15]

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9. Although, at some companies, the highest ranking legal officer is the chief legal officer (to whom a general counsel may report), for the purposes of this Article, the title "general counsel" will be used to denote the highest-ranking legal officer at a company.

10. *See, e.g.*, ASSOCIATION OF CORPORATE COUNSEL & CORPEDIA, INC., 2010 COMPLIANCE PROGRAM AND RISK ASSESSMENT BENCHMARKING 4 (2010) (reporting that twenty-seven percent of corporate survey respondents have a chief compliance officer and thirty percent claimed that compliance was either ultimately overseen by the general counsel). In a survey of over 800 private and public companies and nonprofits among a database of Health Care Compliance Association and Society of Corporate Compliance and Ethics, fifteen percent reported that the general counsel was also the chief compliance officer. SOC'Y OF CORP. COMPLIANCE AND ETHICS & HEALTH CARE COMPLIANCE ASS'N, SHOULD COMPLIANCE REPORT TO THE GENERAL COUNSEL? A SURVEY BY THE SOCIETY OF CORPORATE COMPLIANCE AND ETHICS AND THE HEALTHCARE COMPLIANCE ASSOCIATION 6 (2013), *available at* http://www.corporatecompliance.org/Resources/View/ArticleId/909/Should-Compliance-Report-to-the-General-Counsel.aspx [hereinafter *SCCE Study March 2013*]; *see also* Ford & Hess, *supra* note 2, at 693; *see infra* notes 110–116 and accompanying text.

11. Lori A. Richards, Dir., Office of Compliance Inspections and Examinations, U.S. Sec. and Exch. Comm'n, Compliance Programs: Our Shared Mission (Feb. 28, 2005), *available at* http://www.sec.gov/news/speech/spch022805lar.htm (discussing the emergence of corporate misconduct across large and small industries and the need for change in how "we all think about compliance"); *see infra* note 128.

12. *See infra* notes 125–126 and accompanying text. This appears to be especially true in the healthcare and financial industries. *See, e.g.*, Boehme, *infra* note 174; *see also infra* Part III.A.

13. *See infra* Part II.

14. The Office of Inspector General of the SEC is an independent office in the SEC "that conducts, supervises, and coordinates audits and investigations of the programs and operations of the SEC." *Office of the InSpector General ("OIG")*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/about/offices/inspector_general.shtml (last visited Sept. 30, 2013).

15. The Office of Inspector General of the HHS is responsible for "protect[ing] the integrity of [HHS] programs as well as the health and welfare of the program beneficiaries." Office of the Inspector General, *About Us*, U.S. DEP'T OF HEALTH & HUMAN SERVS. http://oig.hhs.gov/organization.asp (last visited Sept. 30, 2013); *see also The Enforcement of the Criminal Laws Against Medicare and Medicaid Fraud: Hearing Before the H. Judiciary Subcomm. on Crime, Terrorism, and Homeland Security* (2010) (statement of Timothy Menke, Deputy Inspector General for Investigations, U.S. Dep't of Health and Human Services).

each through its Office of Inspector General ("OIG"), have required corporations that misbehaved to develop a distinct compliance department and designate a chief compliance officer that does not report to the general counsel and that has direct access to the board.[16] Concurrently, corporations (not directly pressured by these agencies but prompted by the prospect of leniency) have preemptively buttressed their compliance and ethics programs and, in some cases, reorganized to separate the legal and compliance functions so that the chief compliance officer does not report to the general counsel.[17] These moves have added to what has been identified as a "simmering debate" about compliance oversight and the legal department's potential to be the gatekeeper[18] of compliance.[19]

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16. *See infra* Part III. These mandates (included in consent decrees and deferred prosecution and non-prosecution agreements) do not just require that the corporation must have a standalone compliance department led by a high-ranking official, designated the CCO, who has direct access to or reports to the board, they also explicitly state that the CCO actually *cannot* report to the general counsel. *Id.*

17. Paine, *supra* note 5, at 106 (arguing that companies are motivated, in part, by sentencing guidelines that "base fines partly on the extent to which companies have taken steps to prevent that misconduct"); *cf.* Parker, *Ethics of Advising*, *supra* note 1, at 339 (discussing the incentives for corporations in various industries to voluntarily create compliance and ethics programs); Christine Parker & Sharon Gil ad, *Internal Corporate Compliance Management*, *in* EXPLAINING COMPLIANCE 170 (Christine Parker & Vibeke Lehmann Nelson, eds., 2011); ASEEM PRAKASH & MATTHEW POTOSKI, THE VOLUNTARY ENVIRONMENTALISTS: GREEN CLUBS, ISO 14001, AND VOLUNTARY ENVIRONMENTAL REGULATIONS 1–3 (2006) (making same point). WalMart reported on its website that it created a distinct compliance department along with implementing other compliance programs and procedures. See *Key Events in Walmart Anti-Corruption Compliance*, WALMART, http://news.walmart.com/key-events-in-walmart-anti-corruption-compliance-2012 (last visited Sept. 30, 2013). These changes were implemented before the recent WalMart scandal. *Walmart Global Compliance Action Steps*, WALMART, http://news.walmart.com/walmart-global-compliance-action-steps. (last updated July 8, 2013). Interestingly, legal scholars and the compliance profession (which includes lawyers and nonlawyers) appear to embrace the presumption that adding resources to build internal compliance structures will deter corporate misconduct and/or liability. Krawiec, *supra* note 2, at 489–90 (citing articles arguing in favor of corporate liability mitigation provisions or other incentives that are based on a corporation enhancing internal compliance structures); *see also* Lori Richards, Dir., Office of Compliance Inspections and Examinations, U.S. Sec. and Exch. Comm'n, Instilling Lasting and Meaningful Changes in Compliance, (Oct. 28, 2004), *available at* http://www.sec.gov/news/speech/spch102804lr.htm [hereinafter Richards, *Instilling*]; Lori Richards, Dir., Office of Compliance Inspections and Examinations, U.S. Sec. and Exch. Comm'n, The New Compliance Rule: An Opportunity for Change (June 28, 2004), *available at* www. sec.gov/news/speech/spch063004lar.htm [hereinafter Richards, *New Compliance Rule*].

18. *See, e.g.*, JOHN C. COFFEE, GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 2 (2006) (stating that a gatekeeper is an "agent who acts as a reputational intermediary to assure investors as to the quality of the 'signal' sent by the corporate issuer"); Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53, 53 (1986) (arguing that a gatekeeper is "able to disrupt misconduct by withholding their cooperation from wrongdoers" and can be held liable for failing to do so); Sung hui Kim, *Lawyer Exceptionalism*, 63 SMU L. Rev. 73, 73 (declaring that gatekeepers are "private intermediaries who can prevent harm to the capital markets by disrupting the misconduct of their client representatives").

On the one hand, departmentalizing compliance is consistent with changes in corporate liability rules, sentencing guidelines, and best practices developed by governmental and nongovernmental entities that emphasize the importance of a robust compliance program.[20] On the other hand, however, departmentalization is not consistent with the history and the organization of the compliance function at many large, publicly traded corporations.[21] It is inconsistent with the view taken by the SEC,[22] and the American Bar Association ("ABA"),[23] both of which have developed rules that place general counsels in charge of the compliance function and in the role of compliance gatekeepers.

The primary purpose of this Article is to analyze whether large publicly traded corporations should preemptively departmentalize the compliance function from the legal department so that the chief compliance officer does not report to the general counsel.[24]

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19. Donald C. Langevoort, *Getting (Too) Comfortable: In-house Lawyers, Enterprise Risk and the Financial Crisis*, 2012 WIS. L. REV. 495, 500, 502, 518 (explaining that he is not trying "to resolve the question of whether "legal" and "ethics/compliance" should be separated in an organization" and contending that the answer "depends on the particular firm's history, incentives, and culture." He asks whether there is "something to the claim that lawyers predictably frustrate focus on ethics beyond minimal legal compliance" and suggests research to determine "whether there something in the language, training, socialization, personality and/or professional identity of lawyers that has this effect"); *see generally* Tanina Rostain, *General Counsel in the Age of Compliance: Preliminary Findings and New Research Questions*, 21 GEO. J. LEGAL ETHICS 465, 469 (2008) (questioning whether compliance should be "considered a part of the legal function" or "located outside a corporation's legal department"); *see, e.g.* Jeff Kaplan, *Should the CECO Report to the General Counsel*, CORP. COMPLIANCE INSIGHTS (July 19, 2010), http://www.corporatecomplianceinsights.com/should-the-ceco-report-to-the-general-counsel/; Benjamin W. Heineman, Jr., *Don't Divorce the GC and Compliance Officer*, CORP. COUN., Jan. 2011, at 48,48–49; *SCCE Study March* 2013, *supra* note 10, at 2. Scholars disagree about whether and in what circumstances lawyers should play a gatekeeping role. *See* Kim, *supra* note 18, at 76 (describing the debates around the SEC's efforts to obligate lawyers to gatekeep as "gatekeeping wars"). Although the ABA has established rules that put the lawyer in the role of gatekeeper, in the past it has opposed outside regulation that requires lawyers to serve as gatekeepers or whistleblowers. *Id.* *See infra* Part III.B.2.

20. *See infra* Part III. *See also supra* note 1 and accompanying text. Further, the government's focus on organizational structure and the chain of command is consistent with corporate law's focus on organizational structure. Robert E. Rosen, *Risk Management and Corporate Governance: The Case of Enron*, 35 CONN. L. REV., 1157, 1160 (2003).

21. *See infra* Part II.

22. *Id.*

23. Admittedly, the ABA is a lawyer's trade association, so it may have a built-in bias towards having lawyers in charge (as long as it is self-mandated). However, departmentalization may actually increase the number of jobs for legally trained individuals.

24. This article solely focuses on the debate over departmentalization of the compliance function from the legal department so that the chief compliance officer does not report to the general counsel. Although some might also debate whether there is a need for a "compliance department" or a person with the chief compliance officer title, this article starts with the presumption that large publicly traded corporations have (or should have) personnel to oversee compliance. *See infra* note 43. The question analyzed is: Assuming that the corporation does or

Although there is a great deal of secondary material on compliance (including many surveys conducted by compliance organizations), there has been only minimal scholarly qualitative research done on general counsels and chief compliance officers in the United States about the compliance function in corporations.[25]

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will have personnel to oversee compliance, should those people be part of a department that is entirely separate from the legal department and oversight by the general counsel? Moreover, this Article will not describe in depth the role that chief compliance officer's play at their companies or address whether a person trained in law as opposed to a nonlawyer better fills the chief compliance officer role. A second article, *Creating a Culture of Compliance: Conceptualizing the Role of the Corporate Compliance Officer* (on file with Author) [hereinafter *Conceptualizing the Role*], describes how compliance is managed and positioned within some large publicly traded corporations within the U.S. There, through the voices of the Compliance Study interviewees, the different roles compliance officers can play are identified. *See infra* notes 26–28 and accompanying text. The roles are evaluated and the questions posed at the end of this Article are examined: Who should oversee compliance at large publicly traded corporations, and how? What type of training and skills should these compliance officers have and what roles *should* compliance officers play to effectuate compliance?

25. The following lists the scholarship detailing qualitative empirical work on the compliance function at large U.S. corporations based on a Westlaw search on August 24, 2013. Christine Parker has conducted interviews of U.S. corporations as part of a larger empirical project on compliance and self regulation in Australia. *See, e.g.*, Parker, *supra* note 1, at 339–51 (using interviews of thirty-six Australian and U.S. compliance practitioners to examine the ethical role that should be played by lawyers and compliance professionals and demonstrate that a "superior conceptualization [sic] of the compliance advisor's role is emerging" that "recognizes the interdependence between compliance advisor and corporate client"); Christine Parker, THE OPEN CORPORATION, EFFECTIVE SELF-REGULATION AND DEMOCRACY (2002) (proposing that corporations self-regulate and reporting findings from eighty interviews with regulators and corporate compliance professionals in Europe, the U.S., and Australia). Tanina Rostain has conducted ten interviews with general counsels. Rostain, *supra* note 19 (exploring in-house lawyers' role in compliance based on these interviews). Additionally, qualitative empirical research has been conducted on regulations and the impact of voluntary compliance programs in the environmental arena in the United States. *See, e.g.*, Carey Coglianese, *Beyond Compliance: Explaining Business Participation in Voluntary Environmental Programs*, *in* EXPLAINING COMPLIANCE: BUSINESS RESPONSES TO REGULATION (Vibeke Lehmann Nielsen and Christine Parker, eds. (2011). Lastly, I found one recent qualitative research study on corporate monitorships resulting from settlement agreements. The authors analyze this research in two articles. *See* Cristie Ford & David Hess, *Corporate Monitorships and New Governance Regulation: In Theory, in Practice, and in Context*, 33 L. & POL'Y 509 (2011) (utilizing twenty telephone interviews in 2008 with individuals who have served as monitors in the United States and Canada to "shed light on the sociological and institutional forces that contributed to the underambitious nature of corporate monitorship" and recommend a new governance approach to monitorship); *see* Ford & Hess., *supra* note 2 (investigating the effectiveness of corporate monitorship based on twenty telephone interviews in 2008 with individuals who have served as monitors in the United States and Canada). Both qualitative and quantitative research has been conducted on the compliance function in corporations outside the United States. *See, e.g.*, Robert E. Rosen et al., *The Framing Effects of Professionalism: Is there a Lawyer Cast of Mind? Lessons From Compliance Programs*, 40 FORDHAM URB. L. J. 101 (2013); *see also*, Parker et al., *The Two Faces of Lawyers: Professional Ethics and Business Compliance with Regulation*, 22 GEO. J. LEGAL ETHICS 201 (2009) (utilizing qualitative interviews and surveys to examine the compliance function at Australian companies). Further, there has been some qualitative research on the compliance function at U.S. law firms. *See, e.g.*, Elizabeth Chambliss & David B. Wilkins, *The Emerging Role of Ethics*

Therefore, to generate hypotheses about the consequences of departmentalization and the effects of lawyers as gatekeepers of compliance, seventy general counsels and compliance officers of S&P 500 corporations across a variety of industries including banking, pharmaceutical, and petroleum were interviewed [hereinafter "the Compliance Study"].[26] This interview data was used in combination with secondary material and other studies on compliance to create a case that complicates conventional wisdom about the value of departmentalization. Further, the interview data, quotes, and stories of respondents have been highlighted to better understand how some compliance professionals and lawyers believe the compliance function is both currently and ideally managed[27] as well as to animate the potential issues that may result from removing the general counsel from the role of compliance gatekeeper.[28]

There is a range of different arguments for and against departmentalization.[29] Proponents of departmentalization argue that there is a conflict of interest between the general counsel's role and the compliance officer's role.[30] By separating the two departments, a chief compliance officer will have the autonomy she needs to uncover and report misconduct thereby increasing the level of transparency into corporate conduct (by the board of directors and, in the case of investigations, also by the government).[31] Opponents counter that the benefits of transparency may be offset by the inefficiencies that are created by having a separate and independent compliance function.[32] Communication flow will decrease and costs will increase

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Advisors, General Counsel, and Other Compliance Specialists in Large Law Firm, 44 ARIZ. L. REV. 559, 563-66 (2002) [hereinafter Chambliss & Wilkins, *Complianc Specialists*] (conducting three focus groups that included ten to fifteen lawyers each across thirty-two firms and a few follow-up interviews); *see also* Elizabeth Chambliss & David B. Wilkins, *Promoting Effective Ethical Infrastructure in Large Law Firms: A Call for Research and Reporting*, 30 HOFSTRA L. REV. 691, 694 (2002)[hereinafter Chambliss & Wilkins, *Ethical Infrastructure*] (proposing "a research agenda for the study of ethical infrastructure in large law firms").

26. Included in this are interviews with some former general counsels, a chief ethics officer, a former chair of the ACC's Compliance and Ethics Committee, and a former member of the SEC. For a full description of the interviews and methodology, see *infra* Appendix.

27. As discussed *infra*, the subjects are biased and the interview data is not generalizable given the sample size and format of the empirical work. *See infra* Appendix, describing methodology and limitations of the interview data. This interview data is also relied on in one other article: *Creating a Corporate Culture of Compliance: Conceptualizing the Role of the Corporate Compliance Officer* (on file with Author). For a description, *see supra* note 24.

28. Because the interviews were conducted in a systematic and open manner that promised anonymity and included seventy-one subjects from large publicly traded corporations, the quotes are more than simply stories from random people that the author may have met at a conference. Therefore, the methodology deserves explanation. *See infra* Appendix.

29. *See infra* discussion reviewing and analyzing the arguments at Part IV.

30. *See infra* notes 225–226 and accompanying text.

31. *Id.*; *see also* Part IV.B.

32. *See* Part IV.C.

because of turf wars and the necessity of having duplicate expertise in two departments.[33] Further, they argue, general counsels currently serve as independent counselors to their corporate clients and are accustomed to managing conflicts of interest between their role as an advocate and their role as a keeper of the public trust.[34]

In addition to a range of different arguments, there is a range of different stakeholders affected by this debate, including chief compliance officers, general counsels, the legal profession as a whole, the government, and the public. Arguably, the goals and motivations of each stakeholder can vary.[35] For example, the government may require departmentalization of malfeasant corporations because it wants to prevent future noncompliance but also because it wants to demonstrate to the public that it has forced these corporations to change a prior corporate structure that enabled noncompliance.[36] A corporation, on the other hand, may decide to voluntarily departmentalize because such organizational structure can be used to defend against certain types of liability or mitigate repercussions for future misconduct.[37] Compliance professionals may desire

33. *See* Part IV.B.

34. *See infra* notes 350–357 and accompanying text.

35. Parker & Gilad, *supra* note 17, at 24 ("[D]ifferent actors within (and outside) the corporation might also have different purposes in implementing compliance structures.").

36. According to other compliance scholars, the government's emphasis on internal compliance structural changes is based on the presumption that these changes will reduce noncompliance by corporations. Krawiec, *supra* note 2, at 491; *id.* at 511; Parker & Gilad, *supra* note 17, at 7. Further, it may be that the focus on infrastructure and processes rather than outcomes is easier to measure and not subject to concerns of alternate explanations for bad outcomes. The SEC and the OIG state that they are looking to increase the likelihood that non-compliance will be uncovered and monitored and that a culture of compliance will be created. Sutherland Asbill & Brennan LLP, *Legal Alert: Rule 38a-1 and Rule 206(4)-7 Implementation–Phase 2* SOUTHERLAND, 7-8 (Nov. 1, 2004), http://www.sutherland.com/portalresource/lookup/poid/Z1tOl9NPluKPtDNIqLMRV56Pab6TfzcRXncKbDtRr9tObDdEu83Dq0!/fileUpload.name=/LegalAlertFS1110045%B15%D.pdf [hereinafter *Rule 38a-1 Legal Alert*] ("The SEC will evaluate the compliance culture in the enterprise by assessing whether there are adequate checks and balances, internal controls and supervisory structure that make it more likely that ethical behavior will be the norm within the enterprise . . . . SEC officials have stated that a culture of compliance begins with senior management and that the SEC staff will inquire about the role of the board, senior management and other key executives in setting compliance strategy and holding supervisors responsible for compliance.").

37. Parker & Gilad, *supra* note 17, at 3 ("[C]ompliance systems will often be designed to manage risk and to set up grounds for management to negotiate with regulators that they have tried to do the right thing, rather than the compliance system being designed purely to eliminate noncompliance."); *see also* Robert E. Rosen, *Risk Management and Corporate Governance: The Case of Enron*, 35 CONN. L. REV. 1157, 1157–84 (2003); Dove Izraeli & Mark Schwartz, *What Can We Learn From the U.S. Federal Sentencing Guidelines for Organizational Ethics?*, 17 J. BUS. ETHICS 1045 (1998) (claiming that the primary motivation behind implementing internal compliance structures is to mitigate damages rather than to deter misconduct); Marie McKendall et al., *Ethical Compliance Programs and Corporate Illegality: Testing the Assumptions of the Corporate Sentencing Guidelines*, 37 J. BUS. ETHICS 367, 379 (2002)

departmentalization (and legal professionals oppose departmentalization) in order to increase their power and influence within an organization.[38] Further, each constituent may have a different level of risk tolerance and a different definition of noncompliance.[39]

The range of arguments and stakeholders' perspectives involved make it difficult to analyze the strength of the arguments and reach an overall conclusion about departmentalization. The presumption by the government (and other proponents) appears to be that departmentalization is in the public's interest and will increase: 1) access to information about noncompliance so that some "right" balance of criminal prosecution can be pursued; 2) actual compliance with the law; and 3) a corporation's normative commitment to compliance and building an ethical culture[40] that may not be required

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(explaining that "a growing number of researchers have charged that the purpose of corporate ethical practices is not foremost and genuinely to promote ethical behavior"); *see supra* note 17.

38. *Cf.* Krawiec, *supra* note 2, at 529 ("[L]egal compliance professionals may value incompleteness in the law because, as the first-line interpreters of legal policy, they are able to fill any gaps in incomplete law with terms that enhance the welfare of the legal compliance profession"); *but see* Boehme, *infra* note 173 (contending that compliance professionals are "the least political, power-hungry folks at the company holiday party").

39. Parker & Gilad, *supra* note 17, at 3 (making similar point as between a regulator and corporate managers).

40. The word culture is used here as other compliance scholars have used it: to refer to the informal control systems that involve morals, values, and expectations that affect day-to-day interaction and behavior (as opposed to the structural formal systems and policies). *See* Parker & Gilad, *supra* note 17, at 3; *id.* at 10. *Cf.* Paine, *supra* note 5, at 106 (defining an unethical culture as one where "unethical business practice involves tacit, if not explicit, cooperation of others and reflects the values, attitudes, beliefs, language, and behavioral patterns that define an organization's operating culture"). *See* EDGAR SCHEIN, ORGANIZATIONAL CULTURE AND LEADERSHIP 13–22 (4th ed. 2010); Charles O'Reilly, *Corporations, Culture, and Commitment: Motivation and Social Control in Organizations*, CAL. MGMT. REV., Summer 1989, at 9; *see also* Hess & Ford, *supra* note 25, at 3. For a more detailed discussion of the importance of informal norms (as opposed to formal changes), *see infra* Part V.

There is much support by scholars, compliance professionals, and even government officials for the claim that a culture of compliance is an important ingredient to preventing noncompliance and one of the stated goals of requiring departmentalization. *See supra* note 36; *infra* note 369 and accompanying text. *See also* Paine, *supra* note 5, at 107–09 (reviewing recent corporate misconduct and demonstrating the importance of an organization's ethical culture to employee compliance with the law and ethical behavior); *id.* at 109–10 (contending that a compliance based approach as opposed to one that is based on integrity and instilling an ethical culture is inadequate and providing examples of unethical but legal behavior by corporations that that lead to a "serious crisis of confidence among employees, creditors, shareholders, and customers," executives being "forced to resign, having lost the moral authority to lead," and billions of dollars in company losses). Parker & Gilad, *supra* note 17, at 9–13; Krawiec, *supra* note 2, at 492–93 (defining an organization with a "genuine commitment to legal compliance," as one in which "top management[] [is] dedicate[ed] to ethical corporate behavior" and that has "a corporate culture that reflects that commitment, and an incentive structure that is compatible with and reinforces the goal of legal compliance."); ETHICS RESOURCES CENTER, NATIONAL BUSINESS ETHICS SURVEY 26 (2007), *available at* www.ethics.org/files/u5/The_2007_National_Business_Ethics_Survey.pdf ("Ethical culture is the single biggest factor determining the

by the letter of the law.[41] This Article seeks to add value to the debate by analyzing the strength of the presumptions and arguments in favor of departmentalization from the perspective of the public.[42] Specifically, this Article attempts to identify consequences of departmentalization that are not emphasized in the literature and that may offset the potential benefits of departmentalization.[43]

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amount of misconduct in [an] organization."); Jeff Allen & Duane Davis, *Assessing Some Determinant Effects of Ethical Consulting Behavior: The Case of Personal and Professional Values*, J. BUS. ETHICS 1993, at 449, 456 (finding that corporate culture was more effective at impacting employee behavior than ethics codes); Thomas Tyler et al., *The Ethical Commitment to Compliance: Building Value-Based Cultures*, CAL. MGMT. REV., Fe. 2008, at 31. (showing that failure to look at culture results in less effective compliance programs); Gary R. Weaver et al., *Integrated and Decoupled Corporate Social Performance: Managerial Commitments, External Pressures, Corporate Ethical Practices*, ACAD. MGMT. J., Oct. 1999, at 539, 547 (1999) (finding that sentencing guidelines that promote formal changes like ethics codes are not integrated into the culture of the organization and not as effective as the support of top management); Bazerman & Tenbrunsel, *supra* note 127, at 122 (noting that adopting formal ethics programs may have little effect unless they reflect the values of the organization); *see also* Heineman, *supra* note 19 (referring to a culture of integrity as opposed to a culture of compliance, which in his view includes robust adherence to the spirit and letter of the formal rules, adoption of global standards beyond what the rules requires *i.e.*, ethics and adoption of critical values like honesty, candor, fairness, reliability and trustworthiness); *see supra* note 4. In analyzing this objective, I acknowledge that no one regulatory initiative will directly lead to the creation of a corporate culture of compliance within the organization. Parker & Gilad, *supra* note 17, at 11–13. Further, in addition to the three objectives analyzed here, the public might have other objectives, for example around product innovation and development, that are not related to enhancing compliance and that might be in tension with these three objectives.

41. These objectives are arguably also the objectives behind the government's emphasis on internal compliance structural changes including departmentalization. *See supra* note 36. The government, in dealing with corporate impropriety, appears to favor departmentalization as an offensive measure to prevent future misconduct. For instance, when Schering-Plough pled guilty to providing kickbacks to two HMOs, in addition to paying out more than $290 million in settlement, it entered into a five-year corporate integrity agreement with the government. As part of the agreement, Schering-Plough would have to designate a chief compliance officer who would report directly to the chairman, chief executive officer, and president of the company. Additionally, the chief compliance officer could not be or report to either the general counsel or chief financial officer. *See infra* Part III(A)(1).

42. *Cf.* Parker & Gilad, *supra* note 17, at 24 (suggesting that to analyze the effectiveness of compliance structures, one needs to look at the purposes for which they are employed). This analysis could be conducted from one of the other interested constituency's perspectives; however, the interests of the public will be the primary focus in this Article.

43. This is not to say that enhancing internal compliance structures does not aid in meeting these objectives. This is also not an argument against the designation of a high-ranking chief compliance officer specifically. Indeed, this Article starts with the presumption that the corporation has a designated chief compliance officer. *See supra* note 24. Moreover, research suggests that having a designated chief compliance officer may have a positive impact on compliance procedures and culture. *See* Chambliss & Wilkins, *Compliance Specialists*, supra note 25, at 560 n. 1; *see also* Lauren B. Edelman & Mark C. Suchman, *The Legal Environments of Organizations*, 23 ANN. REV. SOC. 479, 498–501 (1997); *see also* Lauren B. Edelman et al., *Professional Construction of Law: The Inflated Threat of Wrongful Discharge*, 26 LAW & SOC'Y REV. 47, 74–79 (1992) (arguing that compliance specialists are motivated professionally to promote compliance procedures even when no legal threat exists); *cf.* David P. McCaffrey & Sue R. Faerman, *Shared Regulation in the United States Securities Industry*, ADMIN. & SOC.,

Analysis leads to the conclusion that preemptive departmentalization may not work to preserve the public's objectives.[44]

First, departmentalization may not enable the chief compliance officer to have the support, power, and clout needed to fill the role. A compliance officer needs a certain level of political power and influence to be able to utilize an understanding of the law, corporations, and individual motivation to play both an independent and dependent role—acting in both the interest of the public and the corporation.[45] General counsels have that political power. In the last thirty years, they have moved from second-class citizens to being considered one of the highest ranking corporate executives at large publicly traded corporations.[46] Separating the compliance department from the legal department creates a risk that the compliance personnel (whether trained as lawyers or not) will be

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1994, at 204, 227-28 (contending that "[s]elf-regulation seems to work well when self-regulatory "officials" have an identity and power base" and explaining that "[t]he links between government regulators and industry's regulatory/compliance professionals are stronger in the securities industry); *but see* Margaret Raymond, *The Professionalization of Ethics*, 33 FORDHAM URB. L.J. 153, 154–60 (2006) (arguing that designating a person as the chief compliance officer of a firm may have a negative impact); *see infra* note 351. Further, this is not to say that there are not benefits to developing a compliance and ethics department, but it is not clear that this department needs to be independent from general counsel oversight. Rostain, *supra* note 19, at 493 (reporting that one general counsel made this point). The argument in this Article is that departmentalizing the compliance function from general counsel oversight, specifically, may present negative consequences that outweigh the benefits derived from departmentalization. *See infra* note 58. Lastly, this Article is not attempting to empirically evaluate the effects of departmentalization. Others have tried to evaluate the effectiveness of formal compliance systems. *See infra* note 371 and accompanying text. *Cf.* Parker & Gilad, *supra* note 17, at 23–29 (reviewing the empirical evaluation of formal compliance systems, concluding it is difficult to do, and suggesting ways to enhance evaluation). *See infra* note 466.

44. For a discussion of the dangers of the current legal regime that provides very favorable legal treatment to corporations that adopt formal compliance structures (such as codes of conduct and other compliance programs) *see generally*, Krawiec, *supra* note 2 (arguing that internal compliance structures are inefficient and ineffective as they enhance a corporation's "market legitimacy" and reduce corporate legal liability without actually leading to increased deterrence of corporate misconduct).

45. Parker, *supra* note 1, at 345–46; Rosen, *Inside Counsel Movement*, *supra* note 8, at 503.

46. *See generally*, Rosen, Inside Counsel Movement, *supra* note 8; *see also* BEN W. HEINEMAN, JR., THE GENERAL COUNSEL AS LAWYER-STATESMAN, 5 (2010), http://www.law.harvard.edu/programs/plp/pdf/General_Counsel_as_Lawyer-Statesman.pdf (stating that in the past twenty five years, general counsels have been able to take on a "powerful, affirmative leadership role"); *see also* Deborah A. DeMott, *The Discrete Roles of General Counsel*, 74 FORDHAM L. REV. 955, 958–61 (2005) (describing how in the late nineteenth century to the 1930s, general counsels were high-ranking officials. Then they eventually lost their power in the 1940s to marketing and finance types, but ultimately in the 1970s the role began its rise to power once again due to a high demand for in-house legal teams and a wider scope of responsibility); Pam Jenoff, *Going Native: Incentive, Identity, and the Inherent Ethical Problem of In-House Counsel*, 114 W. VA. L. REV. 725, 729 (2012); Rostain, *supra* note 19, at 470–73 (tracing the rise of in-house counsel to senior managers at corporations); *see also infra* note 222.

viewed as another cost center or worse—as "outsiders," (as in-house counsel once were). As a result, compliance officers may lose their ability to be, what, Christine Parker calls, "persuasively relevant."[47] Thus, instead of empowering, such a move may disempower the compliance officer and the compliance department.

Second, the emphasis on compliance departments' independence runs counter to collaboration and interdependency that is crucial to innovation and creative problem solving. To be sure, collaboration can occur between separate and independent departments. However, departmentalizing compliance prizes independence and autonomy and might entrench competition between departments, impeding open communication and the type of interaction that is essential to effective compliance.

Third, a separate and divided reporting structure does not guarantee that the right type of professional with the right skills will lead compliance, and also may result in less substantive expertise devoted to compliance.

Fourth, a uniform mandate may not necessarily increase transparency or uncover more noncompliance. Counter-intuitively, departmentalization may increase the amount of information shielded by the attorney-client privilege once a corporation is involved in an investigation.

Fifth, it is not clear that departmentalization will necessarily increase actual compliance or nurture a culture of ethics within corporations. Because a different department will be the keeper of the corporate conscience, there is a risk that the legal department will become disconnected from the ethical responsibilities of the corporation. If the general counsel no longer monitors ethics or morals,[48] it is possible that a demarcation in reporting lines could create a world in which it is acceptable for lawyers in the legal department to play the role of legal technician—telling clients what they "can" do within the letter of the law and not what they "should" do based on the spirit of the law, ethics, and considerations beyond law. Of course, this is consistent with some aspects of corporate practice and with the agency model of the lawyer-client relationship.[49]

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47. Parker, *supra* note 1, at 349 (explaining that compliance people need to be "persuasively relevant" and "sufficiently committed to ethical and legal responsibilities with the stature and clout for people to listen when they suggest different ways of doing things or put their foot down. The most effective change agent is an insider").

48. *Id.*

49. David B. Wilkins, *Team of Rivals? Toward a New Model of the Corporate Attorney-Client Relationship*, 78 FORDHAM L. REV. 2067, 2075 (2010) [hereinafter Wilkins, *Rivals*] ("By characterizing the relationship between corporate lawyers and their clients as fundamentally one of agency, the standard account systematically marginalizes, and indeed delegitimizes, a lawyer's allegiance to this broader public role."); David B. Wilkins, *Do Clients Have Ethical*

However, it is inconsistent with much of the U.S. legal profession's history, which, since 1820, has portrayed the lawyer's role as a dual one: client advocate and public servant.[50]

Lastly, if the goal is to create a culture of ethics that is ingrained in everyday life of the organization,[51] then the current government's focus on the formal exemplifications of a commitment to compliance may be misplaced. The new organizational structure may create a false sense of complacency about compliance. When dealing with routine check-the-box processes, noncompliance with these requirements is easy to uncover, and compliance is easy to motivate. However, when the choice involves, nonroutine, complex, multifaceted choices about ethics, morals, or personal preferences, malfeasance is much harder to control. Rather, to find critical gaps to ensure the right values are integrated, focus and attention might be better placed on the internal aspects of an organization—how people actually interact and work together, how they form networks, and how they are motivated and make ethical decisions.

Thus, the main hypothesis of this Article is that preemptively departmentalizing compliance may (instead of being best practice) elevate form over function.[52] Such a move *may* in some circumstances support embedded compliance programs but it (perhaps along with other trappings of a compliance and ethics program like a code of conduct, an annual audit, and an ethics training program) may not *necessarily* be an effective compliance mechanism itself.[53] Instead, departmentalization may generate

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Obligations to Lawyers? Some Lessons from the Diversity Wars, 11 GEO. J. LEGAL ETHICS, 855, 855–56 (1998) [hereinafter Wilkins, *Diversity Wars*] ("The agency model of the lawyer's role assumes that all ethical obligations flow from the lawyer-agent to the client-principal.").

50. Wilkins, *Rivals*, *supra* note 49, at 2073–75 (tracing this dual obligation from 1820 to today and arguing that the agency model and market conditions make it difficult for lawyers to play a gatekeeping role).

51. Parker, *supra* note 1, at 346.

52. According to leading researchers on organizational theory, sometimes organizational structure is a result of "the myths of their institutional environments instead of the demands of their work activity." John W. Meyer & Brian Rowan, *Institutionalized Organizations: Formal Structure as Myth and Ceremony*, *in* THE NEW INSTITUTIONALISM IN ORGANIZATIONAL ANALYSIS (Walter W. Powell & Paul J. DiMaggio eds., 1983). Others contend that homogenization in organizational structure, culture, and output across industries is not necessarily "driven by competition or by the need for efficiency." *Id.* at 63–64. Instead, such bureaucratization stems from "individual efforts to deal rationally with uncertainty and constraint." *Id.* at 64. For an argument that formal compliance structures are merely window dressing without real substantive change, *see generally* Krawiec, *supra* note 2; *see also infra* note 58.

53. *See, e.g.*, Parker, *supra* note 1 at 346; *cf.* Krawiec, *supra* note 2, at 487–544; *see also* Parker & Gilad, *supra* note 17, at 3 ("[R]esearch shows that implementation of compliance management systems often does not and cannot achieve idealistic policy purposes because corporate managements implement them partially and halfheartedly for the purposes of external impression management of 'window dressing' without making the necessary

consequences that subvert the potential benefits of departmentalization and create a sense of false complacency that distracts from substantive cultural change.

Ultimately, the analysis indicates that departmentalization is the wrong answer because the right question is not about independence but instead about connectivity, informal norms, ethics, and motivation.[54] If that is true, the more important question (one that is left for another day and another article)[55] may be: Regardless of the organizational structure, *who* should oversee compliance? What expertise and skills should these compliance officers have, should they have legal or management or other training? And what roles should compliance officers fill to best execute the compliance function?

This Article is divided into four parts. Part II, provides a context for the rest of the Article, beginning with a brief overview of the regulatory and case history behind compliance oversight and continuing with a short description of the compliance function at large publicly traded corporations based on trade surveys, secondary literature, and interview data from the Compliance Study.

Part III, discusses examples of corporations that have been identified by governmental agencies as failing to adhere to compliance guidelines. This Article examines the agreements that these corporations have entered into with the OIG of the SEC and DHHS and identify commonalities across them[56] (one of which is that compliance should be managed by a separate department that is independent from general counsel oversight). The Article then compares this position to recommendations by the United States Sentencing Commission, the SEC, and the ABA, which support general counsels having compliance gatekeeping responsibilities.

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substantive changes to achieve external policy goals."). *See also infra* note 58 (reviewing arguments by other scholars that trappings of compliance programs, such as ethics codes and high ranking officers, can support but are not sufficient to create substantive sustainable compliant culture in a corporation).

54. In other words, the right question is not whether compliance should be independent from the legal department.

55. *See supra* note 24

56. It is true that defining what is compliance is difficult to do and that the compliance function varies by corporation and industry. Jose A. Tabuena, *The Chief Compliance Officer vs the General Counsel: Friend or Foe*, SOC'Y OF CORP. COMPLIANCE AND ETHICS, 3 (2006), *available at* www.corporatecompliance.org/Portals/1/PDF/Resources/past_handouts/CEI/2008/601-3.pdf ("Most people can articulate what a lawyer or auditor does for a living, but the average employee may have difficulty defining 'compliance.'"). However, this Article is written with the assumption that the reader has a basic understanding of the compliance function at large corporations. It focuses solely on the question of departmentalization. For a more thorough description of the compliance function at large publicly traded corporations, *see Conceptualizing the Role*, *supra* note 24 (on file with Author) and sources *cited supra* in note 25.

Part IV outlines the common arguments for and against departmentalization. Because it is sometimes unclear in the literature for what purpose and for which constituency's benefit departmentalization is being proposed, the article proceeds by categorizing the arguments into three types: 1) autonomy and independence; 2) transparency and efficiency; and, 3) role arguments.[57] Utilizing this typology, the article examines the strength of the arguments for departmentalization from a public interest perspective. In so doing, this Article attempts to uncover potential drawbacks of departmentalization that have yet to be emphasized in the literature and that may—instead of preserving—subvert the potential benefits of departmentalization.

Ultimately, this analysis leads to the hypothesis that preemptively adopting this particular organizational structure for compliance may not actually be in the best interest of the public. Instead of leading to an increase in transparency, enhanced compliance, or a stronger commitment to compliant and ethical behavior, departmentalization could make things worse.

Utilizing research on internal norms, networks, ethical decision-making, and motivation, Part V, suggests that the government is focused on the wrong proxies for creating a culture of compliance and that such proxies may lead to a false sense that the problems in corporate compliance are fixed.[58] Therefore, this Article proposes that instead of emphasizing departmentalization (or other compliance trappings), the government should reward corporations that take an

57. Unsurprisingly, these three types of arguments are commonly utilized in debates about the ideology of the legal profession and the rules governing lawyers' conduct. *Cf.* David B. Wilkins, *Everyday Practice is the Troubling Case: Confronting Context in Legal Ethics, in* EVERYDAY PRACTICES AND TROUBLE CASES 68, 70-75 (Austin Sarat et al. eds., 1998) (analyzing assumptions that underlie the image and ideology of the legal profession and how these assumptions affect lawyers' conduct); *see generally* Richard Wasserstrom, *Lawyers as Professionals: Some Moral Issues,* 5 HUM. RTS. 1 (1975) (analyzing professional roles, including the role of lawyer, on moral rights and obligations).

58. For example, if a law school's response to changing needs of law students was to hire four more administrative assistants for each professor, it might not make legal education worse but it might make the law school think it solved the problem when it did not. This is not to say that formal compliance structures do not affect compliance at all or help construct organizational culture but, instead, that they are not sufficient on their own. *See* Paine, *supra* note 5, at 112 ("A glossy code of conduct, a high-ranking ethics officer, a training program, an annual ethics audit—these trappings of an ethics program do not necessarily add up to a responsible, law abiding organization whose espoused values match its action. A formal ethics program can serve as a catalyst and a support system but organizational integrity depends on the integration of the company's values into the driving systems."); *see also* Parker & Gilad, *supra* note 17, at 5. However, as others have noted, it is extremely difficult to determine if compliance structures are adopted as symbolic calculated responses to reputation and liability risk or to help develop a sustainable commitment to public goals and values. *Id.* at 28. *See supra* note 52.

inward look at how work is actually being accomplished within the company and that attempt to affect change based on the networks and organizational culture that exists beneath the surface of the organization chart, the mission statement, and code of conduct. Such focus could enable an organization to effectively implement compliance structures, policies, and norms that become integrated throughout the organization and create a culture of compliance.

II. OVERVIEW: THE REGULATORY HISTORY OF CORPORATE GOVERNANCE AND THE COMPLIANCE FUNCTION AT LARGE PUBLICLY TRADED CORPORATIONS

In the past fifteen years in the wake of the corporate scandals that spanned industries (pharmaceutical, insurance, financial services, health care, consumer products), the compliance function at large, publicly traded corporations has received a great deal of attention—both from the press and from Congress.[59] As will be demonstrated in this Part (and the following Part), changes in corporate liability rules, federal sentencing guidelines, and the way the government has negotiated presettlement and consent decree agreements have supported the move by corporations to reorganize and buttress their compliance initiatives.[60] This Part begins by providing a brief overview of the regulatory history behind corporate governance as it relates to compliance[61] and a general description of the compliance function at large publicly traded corporations.[62]

A. Brief Overview of the Regulatory History Behind Corporate Compliance

Today, the compliance function at large, publicly traded corporations includes creating and managing policies and procedures around ethics and compliance to uncover and prevent misconduct. Corporate compliance programs developed over time in response to liability rule changes, sentencing guidelines, settlement incentives,

59. *See, e.g.*, Orland, *supra* note 1, at 50 (explaining that "[e]xtraordinary and unprecedented episodes of corporate wrongdoing burst upon the national scene in 2002" and tracing the history of criminal corporate law and introduction of the Sarbanes Oxley Act of 2002); *see also supra* note 11 and *infra* notes 210–11 and accompanying text.

60. *See infra* Part III. *See also supra* note 1 and accompanying text.

61. This overview is intended to serve as a brief synopsis and is written with the assumption that the reader has a familiarity with corporate law and the compliance regulatory environment.

62. For a more detailed description, see DeStefano, *Conceptualizing the Role*, *supra* note 24 (on file with Author).

and prosecution agreements.[63] In the 1960s, the government prosecuted a group of heavy electric equipment companies for antitrust violations.[64] General Electric argued that the strength of its compliance program should be considered as part of its criminal defense.[65] In response, other companies bulwarked their compliance departments as a defensive measure.[66] Similarly, in the 1970s, the Foreign Corrupt Practices Act of 1977 incented corporations to develop more robust compliance programs in response to its requirement that corporations develop internal controls to prevent corruption.[67] In the 1980s, after a whistle-blower uncovered fraudulent acts by government defense contractors, the Department of Defense required contractors to adopt a written code of conduct and develop training programs and compliance procedures.[68] Then, in the early 1990s, the United States Sentencing Commission passed the Organizational Sentencing Guidelines ("OSGs").[69] The OSGs mitigated corporate criminal penalties if organizations could show they had an "effective" compliance program—which could be demonstrated by the adoption of internal compliance structures.[70]

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63. Ford & Hess, *supra* note 2, at 689. Parker, *supra* note 1, at 339; *see also* Ashoke S. Talukdar, *The Voice of Reason: The Corporate Compliance Officer and the Regulated Corporate Environment*, 6 U.C. DAVIS BUS. L. J. 3, § I (2005), *available at* http://blj.ucdavis.edu/archives/vol-6-no-1/The-Voice-of-Reason.html. The development of the compliance function is obviously related to the criminal law applied to corporate entities. For a history of American corporate criminal law and Congress's response to corporate liability (in the form of the Sentencing Reform Act of 1984, the Organization Guidelines in 1991, and the Sarbanes-Oxley Act of 2002), *see* Orland, *supra* note 1, at 46–52.

64. *See, e.g.*, Harvey L. Pitt & Karl A. Groskaufmanis, *Minimizing Corporate Civil and Criminal Liability: A Second Look at Corporate Codes of Conduct*, 78 GEO. L.J. 1559, 1578 (1990); *see also* Ford & Hess, *supra* note 2, at 689.

65. *See* Pitt & Groskaufmanis, *supra* note 64. Ford & Hess, *supra* note 2, at 689.

66. *See, e.g.*, Pitt & Groskaufmanis, *supra* note 64. *See also* Ford & Hess, *supra* note 2, at 689.

67. Pitt & Groskaufmanis, *supra* note 64, at 1580–82; Marika Maris & Erika Singer, *Foreign Corrupt Practices Act*, 43 AM. CRIM. L. REV. 575, 578, 582–90 (2006).

68. DEF. INDUS. INITIATIVE ON BUS. ETHICS AND CONDUCT, 2000 ANNUAL REPORT 27–28 (2000). *See also Origins and Development of the Defense Industry Initiative*, DEF. INDUS. INITATIVE, *available at* http://www.dii.org/annual/2000/origins.html. *See* Ford & Hess, *supra* note 2, at 689 (citing Nancy B. Kurland, *The Defense Industry Initiative: Ethics, Self-Regulation, and Accountability*, 12 J. BUS. ETHICS 137 (1993)); Krawiec, *supra* note 2, at n.29 (explaining that DII was later copied by other troubled industries, including the health care industry, which has been plagued repeatedly by Medicare fraud and drug company kickback scandals). This agreement was termed the Def. Indus. Initiative. For a description of the organization and its goals, *see* DEF. INDUST. INITIATIVE, http://www.dii.org (last visited May 15, 2013).

69. Paula Desio, *An Overview of the Organizational Guidelines*, U.S. SENTENCING COMM'N, *available at* http://www.ussc.gov/Guidelines/Organizational_Guidelines/ORGOVERVIEW.pdf.

70. U.S. SENTENCING GUIDELINES MANUAL §8C2.5 (2001) (detailing other culpability factors that could mitigate sentencing); *see also infra* note 79; Diana E. Murphy, *The Federal*

The promulgation of the sentencing guidelines was partnered with the now well-known *In re Caremark* case,[71] interpreted by the Delaware Supreme Court in *Stone v. Ritter*.[72] The guidelines require the board to adopt compliance programs to receive mitigation in sentencing.[73] Then, in the early 2000s, in response to corporate scandals like Enron, Arthur Anderson, and Tyco, Congress passed the Sarbanes-Oxley Act, which in addition to applying penalties to individuals, also addressed the corporate governance function for entities.[74] This

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Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics, 87 IOWA L. Rev. 697, 702–03 (2002). The United States Sentencing Commission promulgated the Sentencing Reform Act of 1984. *See* 28 U.S.C. § 991(a) (Supp. III 2003). In 1987, it instituted mandatory guidelines for individuals. U.S. SENTENCING GUIDELINES MANUEL § 2-7 (1987). These guidelines were then applied to organizations in 1991. U.S. SENTENCING GUIDELINES MANUEL § 8 (1991); *see* Orland, *supra* note 1, at n.21 (explaining the difference in purpose between the individual and the organizational guidelines); *see also* JED S. RAKOFF ET AL., CORPORATE SENTENCING GUIDELINES COMPLIANCE AND MITIGATION § 1.04[2] (2005). The Supreme Court eventually ruled that these mandatory guidelines were unconstitutional. United States v. Booker, 543 U.S. 220, 220 (2005). However, they still have weight in their advisory role. *See* Orland, *supra* note 1, at 49–50 (explaining that it is not clear whether Booker extends to the Organizational Guidelines, but even if it does, the guidelines have still been "a major factor in the development of the law and practice of corporate compliance" and "will continue to have an impact on corporate governance"); *see also* Ford & Hess, *supra* note 2, at 691 (explaining that in 1999 the "DOJ officially stated that it would take into account the adequacy of a corporation's compliance program when deciding whether to prosecute a corporation, as opposed to just prosecuting any individuals involved in the criminal activity," citing Diana E. Murphy, *The Federal Sentencing Guidelines for Organizations: A Decade of Promoting Compliance and Ethics*, 87 IOWA L. REV. 697, 702–03 (2002)). In a Memorandum, Eric Holder, Deputy Attorney General, stated that, when considering whether to charge a corporation, a prosecutor should consider whether the corporation had an adequate and effective compliance program. Memorandum from Eric H. Holder, Jr., Deputy Attorney Gen., U.S. Dep't of Justice to All Component Heads and U.s. Attorney (June 16, 1999) [hereinafter Holder Memo], *available at* http://www.justice.gov/criminal/fraud/documents/reports/1999/charging-corps.PDF. Later, in 2003, this memo was revised by Larry D. Thompson, and then by Paul J. McNulty in 2006. Memorandum from Larry D. Thompson, Deputy Attorney Gen., U.S. Dep't of Justice to Heads of Dep't Components, U.S. Attorneys (Jan. 20, 2003); Memorandum from Paul J. McNulty, Deputy Attorney Gen., U.S. Dep't of Justice to Heads of Dep't Components, U.S. Attorneys (Dec. 12, 2006), *available at* http://www.justice.gov/day/speeches/2006/mcnulty-memo.pdf (stating that "that prosecutors may not consider whether a corporation has sanctioned or retained culpable employees in evaluating whether to assign cooperation credit to the corporation."). *See also* Ford & Hess, *supra* note 2, at n.91 (detailing this history); *see also* Orland, *supra* note 1, at 52–56.

71. *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996) (holding that business judgment rule protection only applies to directors who "exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations").

72. Stone v. Ritter, 911 A.2d 362 (Del. 2006).

73. Ford & Hess., *supra* note 2, at 690 (making same point and citing Hillary A. Sale, *Monitoring Caremark's Good Faith*, 32 DEL. J. CORP. L. 719, 730–33 (2007)).

74. Orland, *supra* note 1, at 51–52 (explaining that "[t]hese new Sarbanes-Oxley criminal prohibitions and penalties appear to apply only to individuals, not corporate entities. Sarbanes-Oxley fails to address rules for determining entity liability and does not establish new or

represented a change in approach. Instead of focusing on penalizing the individual actors and fining the corporation, the Department of Justice ("DOJ") and SEC began directing corporate governance by requiring certain changes to corporate structure, policies, programs, and personnel relating to compliance.[75]

As will be discussed further in Part II, the recent revisions to the sentencing guidelines include recommendations around the compliance and ethics programs, and reporting structure.[76] Additionally, in deferred prosecution and nonprosecution agreements, various governmental departments have required structural changes to the compliance function.[77] These developments have justified the implementation of a robust compliance function at large, publicly traded, corporations.[78] In addition to departmentalization and designating a high-ranking compliance officer, many corporations have adopted a written code of ethics, training programs, monitoring and audit systems, and reporting procedures.[79] Unsurprisingly, with the increased emphasis on

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increased entity criminal sanctions" and arguing that "[t]he most important post-Sarbanes-Oxley development has been the proliferation of corporate deferred prosecution and non-prosecution agreements, coupled with indictments of senior management, including Chief Executive Officers, Chief Financial Officers, and General Counsels, of the corporations that were the beneficiaries of the corporate agreements").

75. Ford & Hess, *supra* note 25, at 3 (noting that these agreements also often require corporations to hire an independent monitor to manage and oversee the revised compliance programs).

76. U.S. Sentencing Guidelines Manual (Proposed Amendments 2010), *available at* http://www.ussc.gov/Legal/Amendments/Reder-Friendly/20100121-RFP_Amendments.pdf.

77. *See infra* Part III; *see also* Krawiec, *supra* note 2, at 500–01 (explaining that the Environmental Protection Agency and the Department of Health and Human Services "borrow heavily from the OSG's internal compliance-based liability regime in recent policies and guidelines"). For an overview of the use of deferred prosecution and non-prosecution agreements, *see generally* Brandon L. Garrett, *Structural Reform Prosecution*, 93 VA. L. REV. 853, 856 (2007); Benjamin M. Greenblum, Note, *What Happens to a Prosecution Deferred? Judicial Oversight of Corporate Deferred Prosecution Agreements*, 105 COLUM. L. REV. 1863 (2005); Jennifer O'Hare, *The Use of the Corporate Monitor in SEC Enforcement Actions*, 1 BROOK J. CORP. FIN COM. L. 89 (2006); Orland, *supra* note 1.

78. Christine Parker, *Lawyer Deregulation via Business Deregulation: Compliance Professionalism and Legal Professionalism*, 6 INT'L J. LEGAL PROF. 175, 175–80 (1999) (reporting that a 1996 Price Waterhouse survey of 240 large U.S. companies found that as of 1996 "86% had a formal compliance; 9% were developing a policy and only 5% had no policy," citing Angela Ward, *Compliance Survey: Companies Say Better Safe Than Sorry*, 62 CORP. LEGAL TIMES, 1-3 (1997)); Paine, *supra* note 5, at 106.

79. Paine, *supra* note 2, at 112; Krawiec, *supra* note 2, at 496. These features are also what the Organizational Sentencing Guidelines define as minimum requirements for an "effective" compliance program that would justify a reduced sentence. U.S. SENTENCING GUIDELINES MANUAL §8A1.2(k)(1) (2001); U.S. SENTENCING GUIDELINES MANUAL §8A1.2(k)(2) (2001). They are also consistent with the recommendations by professional associations and consultants. Krawiec, *supra* note 2, at 496; Marie McKendall et al., *Ethical Compliance Programs and Corporate Illegality: Testing the Assumptions of the Corporate Sentencing Guidelines*, 37 J. BUS. ETHICS 367, 372 (2002). Ford & Hess, *supra* note 2, at 692–94.

compliance and its structure and organization at corporations, a new profession of compliance professionals has developed.[80] The number of lawyers (and non-lawyers) that consider themselves part of this new compliance profession has grown in addition to the number of professional associations and conferences dedicated to compliance.[81]

B. DESCRIPTION OF THE CORPORATE COMPLIANCE FUNCTION

Compliance means different things to different people and it varies by industry. For the purposes of this Article, however, it is useful to establish a common understanding of what is meant by "compliance" by reviewing the secondary literature and interview data from the Compliance Study that helps to define the compliance function and the professional skills of compliance officers.[82]

1. *Compliance Function*

Putting aside the debate about whether the compliance function is or should be considered a legal function,[83] it is difficult to tell where legal ends and compliance begins.[84] Secondary research and the Compliance Study interviews support the conclusion that both legal and compliance personnel rely on legal expertise to do their job[85] and they have a shared goal: to increase compliance with the law.[86] Compliance personnel have to understand formal rules and laws and assess risk. Compliance officer and general counsel interviewees often said things like compliance involves "law, regulations, and general standards of ethical behavior"[87] or compliance is to me a very

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80. Parker, *supra* note 1, at 339.

81. Parker, *supra* note 1, at 339 (making similar point about lawyer and nonlawyer compliance professionals and associations); Ford & Hess, *supra* note 2, at 692–94. Ford & Hess, *supra* note 25, at 2.

82. However, the compliance function is admittedly more complex than presented here.

83. As discussed *infra*, there is an assumption that compliance is not a truly legal function and indeed nonlawyers do serve as compliance officers. *See infra* pp. 121–122 and accompanying text. However, analyzing the pros and cons of compliance professionals having formal training as lawyers is outside the scope of this Article and is a subject of a future article. *Conceptualizing the Role*, *supra* note 24.

84. Langevoort, *supra* note 19, at 500 ("There is no clear conceptual distinction between legal advice and compliance oversight.").

85. *See* Jose A. Tabuena & Jennifer L Smith, *The Chief Compliance Officer Versus the General Counsel: Friends or Foes? Part II, 8*, J. HEALTH CARE COMPLIANCE, 13, 13-15 (2006); *see infra* notes 298–302 and accompanying text.

86. Joseph E. Murphy, et al., *General Counsel as CCEO? Not an obvious Answer*, COMPLIANCE AND ETHICS MAG., June 2009, at 3, 6.

87. Interviewee Stage 2 GC6 at 2. The Interviewees are anonymous and thus they are coded throughout. "Stage 1" interviews were done in 2006–2007 and all interviews done in 2010–2012 are designated "Stage 2." The title of the interviewee is designated as follows: GC is general

legal function."[88] Compliance cases are, akin to

> handling litigation—employee rights and privacy and making sure that the investigation is appropriate and what kind of record are we creating—and what we are telling regulators. It is all very intertwined with lots of rules and regulations . . . that part of what I do is oftentimes in the legal department.[89]

The compliance function is also entwined with ethics (and values)—which is also an area that those in the legal department sometimes oversee.[90] Further, whether it is due to the revisions to the Federal Organizational Sentencing Guidelines in 2004 and again in 2010,[91] or research that shows that more effective compliance

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counsel, FGC is former general counsel, CO is compliance officer, CCO is chief compliance officer, CEO is chief executive officer, CXO is chief ethics officer, CA is a compliance activist, and CGO is a governmental official overseeing compliance. The number in the code designates the interview identification number assigned to that particular anonymous interviewee. In a few instances in Stage 2, follow-up interviews were conducted. In those instances, the interview is coded with a number and the letter "a" for the first interview and "b" for the follow-up interview. The page number refers to the transcript or notes if the interview was not recorded. *See infra* Appendix for more detail.

88. CCO2 at 10 ("[U]ltimately what you are talking about is compliance with the law and /or compliance with regulations. Then that means somebody has to know what the laws and regulation are and they have to understand what the issues are and decide whether or not compliance is actually occurring and that's very typically, especially in our industry, a very complicated thing and a very difficult analysis.").

89. Interviewee Stage 2 CCO 15 at 10–11. If it is true that training as a lawyer helps compliance officers do their job and compliance officers themselves believe they are interpreting and advising on the law, the question might be whether nonlawyer compliance officers are violating unauthorized practice of law statutes. For a detailed analysis of this issue *see* Michele DeStefano, *Compliance and Litigation Funding: Testing the Borders of Lawyers' Monopoly and the Unauthorized Practice of Law*, FORDHAM L. REV. (forthcoming 2014). *See supra* notes 127 and 289. It is also interesting to note that this conflicts with the presumption that compliance is not a "legal" function and a law degree is not required to be a compliance officer. *See supra* note 83. *See also infra* notes 121–122 and accompanying text.

90. Giovanni P. Prezioso, Gen. Counsel, U.S. Sec. and Exch. Comm'n, Speech by SEC Staff: Remarks before the Spring Meeting of the Association of General Counsel (Apr. 28, 2005), *available at* http://www.sec.gov/news/speech/spch042805gpp.htm (explaining that general counsels should be viewed as the gatekeepers of ethics); *see* Tod Reichert et al., *The Roles of General Counsel and Chief Compliance Officers*, CORP. COMPLIANCE INSIGHTS (Jan. 18, 2011), http://www.corporatecomplianceinsights.com/the-roles-of-general-counsel-and-chief-compliance-officers/ (explaining that it is common for general counsels to oversee compliance and ethics programs "based on the premise that compliance is essentially a legal matter and, after all, the legal department is often the source of the recommendation to create such a position based on its awareness of the Federal Sentencing Guidelines, applicable laws and guidance from regulators who encourage companies to adopt rigorous compliance programs"). In Stage 2 of the Compliance Study, twenty-seven percent of general counsels and sixty-six percent of compliance officers reported overseeing the ethics function.

91. The amendments refer to the "compliance and ethics program" of a corporation and define an effective program as one that is structured to "prevent and detect criminal conduct" and to "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law." U.S. SENTENCING GUIDELINES MANUAL 18 U.S.C. § 8B2.1(a) (2004).

programs include elements of both compliance-based and integrity-based approaches,[92] the compliance function at large, publicly traded corporations is generally focused on a combination of: 1) compliance detection, prevention, and response policies; and, 2) ethics initiatives.[93] The following will attempt to briefly unpack these two focuses.

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92. Ford & Hess, *supra* note 2, at 692 (making point that empirical studies show that integrity-based programs are more effective than compliance-based programs and that "the importance of managing an organization's culture to ensure the effectiveness of a compliance program gained significant traction when the Sentencing Commission formalized it as part of the Organizational Sentencing Guidelines in 2004"); Lynn Sharp Paine, *Managing for Organizational Integrity,* HARV. BUS. REV., Mar.–Apr. 1994, at 106, 110–11 (making the distinction and explaining that some utilize an "integrity-based" approach that focuses on values and empowerment while others take a "compliance based" approach that is based on punishment for transgressions); David Hess, *A Business Ethics Perspective on Sarbanes-Oxley and the Organizational Sentencing Guidelines,* 105 MICH. L. REV. 1781, 1791–94 (2007) (discussing empirical studies demonstrating that integrity-based programs are more effective); *see supra* note 8; *see also infra* note 427 and accompanying text. There is also research supporting the fact that a self-regulatory approach is more effective than a command-and-control approach. Hasnas, *supra* note 5, at 516–17 (contending that "empirical research demonstrates that the self-regulatory, procedural justice approach is significantly more effective at reducing the level of illegal and unethical behavior among an organization's employees than the command-and-control approach" but that "a business can actually increase its risk of federal indictment by adopting the most effective methods of reducing employee criminal activity"); *see also* Marius Aalders & Ton Wilthagen, *Moving Beyond Command and Control: Reflexivity in the Regulation of Occupational Safety and Health and the Environment,* 19 LAW & POL'Y 415 (1997) (reviewing problems with the "command-and-control" approach and recommending changes to the self-regulation approach); Jay A. Sigler & Joseph E. Murphy, *A Novel Approach to Business-Government Relationships, in* CORPORATE LAWBREAKING AND INTERACTIVE COMPLIANCE: RESOLVING THE REGULATION-DEREGULATION DICHOTOMY 1, 4–15 (Jay A. Sigler & Joseph E. Murphy eds., 1991) (proposing a system in which corporations take a self-regulatory approach so as to reduce the need for government scrutiny). Some commentators claim that the government's focus on ethics and on other aspects of compliance like corporate monitorships "demonstrate a broader regulatory trend that recognizes the limits of regulating corporations through external prescriptions and inspections, and therefore directs its energies towards encouraging corporations to engage in meaningful self-regulation through the adoption of effective internal compliance programs." Ford & Hess, *supra* note 25, at 2; *see supra* note 5.

93. Parker, *supra* note 1, at 340. *See* Ford & Hess, *supra* note 2, at 689–95 (showing that corporate compliance programs now focus on compliance, ethics, and corporate culture); Caron Carlson, *How the Modern CCO Came to Be,* COMPLAINCE WEEK, (Feb. 20, 2008), http://www.complianceweek.com/pages/login.aspx?returl=/how-the-modern-cco-came-to-be/article/185468/&pagetypeid=28&articleid=185468&accesslevel=2&expireddays=0&accessAndPrice=0; Parker, *supra* note 78, at 183 ("[C]ompliance professionals understand their work as being about the articulation, accommodation and harmonization of legal norms to organizational culture, corporate governance systems and business goals."); Paine, *supra* note 5, at 106 (explaining that the goal of compliance department is to "prevent, detect, and punish legal violations. But organizational ethics means more than avoiding illegal practice; and requires a "comprehensive approach"). Arguably, Corporate Social Responsibility ("CSR") efforts are related to the compliance function given the compliance function's emphasis on ethics and its objective to help corporations go beyond what is required by the letter and spirit of the law. Andrew Stone, *Where Next for Corporate Social Responsibility?,* PERFORMANCE PREVIEW, 5 (Sept. 2011) (citing Colin Crouch as explaining that CSR is all about "recognizing and acting on negative externalities" and going beyond the requirements of regulations because they could

Although there is disagreement about who should oversee compliance, where compliance should be housed, and what role the general counsel should play vis-a-vis the chief compliance officer,[94] secondary literature and Compliance Study interviews appear to agree that those in charge of compliance should: 1) build policies and procedures; 2) monitor adherence to those policies and procedures; 3) train and educate employees on specific regulatory obligations; and, 4) test employees on adherence and remediate when necessary.[95] A typical description of the position by a compliance professional follows:

> We are basically advising the business on the requirements for an effective compliance program. So we provide advice on what the management, support and resources should be

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affect the business") http://performance.ey.com/wp-content/uploads/downloads/2011/11/EY_performance_Preview2_pg03-05_CSR.pdf; *see also* Stephen Brammer, et al., *Corporate Social Responsibility and Institutional Theory: New Perspectives on Private Goverance, Socio-Economic Review*, 10 SOCIO-ECON. REV. 1, 3–28 (applying institutional theory to understanding CSR as a mode of governance). For a series of articles discussing what defines a "responsible" corporation and how corporate responsibility initiatives fit within the other goals of a corporation, *see generally* COLIN CROUCH & CAMILLA MACLEAN, THE RESPONSIBLE CORPORATION IN A GLOBAL ECONOMY, (2012). Interestingly, although there appears to be an increased emphasis on compliance in the past few years, since the financial crisis, it appears there has been a decreased emphasis on CSR. Stone, *supra* note 93, at 4 (explaining that "[t]hose companies that confidently expect to be around for a long time are more likely to act responsibly"); *see also* Maria Gjolberg, *The Origin of Corporate Social Responsibility: Global Forces or National Legacies*, 7 SOCIO-ECON. REV., 605, 605 (hypothesizing that "a company's CSR efforts are a function of the dictates of the global market place" and that "[t]hose that are trapped in sectors where the crisis has hit hardest do not take a long-term view and will simply seek to reduce costs as much as possible"). This may change, however, as the government and/or company stakeholders begin to demand corporations to report on CSR initiatives. Sarah E. White, *The Rising Global Interest in Sustainability and Corporate Social Responsibility Reporting*, SUSTAINABILITY. (Oct. 5, 2011), http://sustainability.thomsonreuters.com/2012/10/05/the-rising-global-interest-in-sustainability-and-corporate-social-responsibility-reporting. Indeed, a recent report by KPMG, found that the percentage of companies reporting their CSR activities within and outside the U.S. is increasing. *Corporate Responsibility Reporting Has Become De Facto Law for Business*, KPMG, http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/corporate-responsibility/ Pages/de-facto-business-law.aspx (last visited Aug. 29, 2013). It claimed that corporations are under pressure to do so, in part because "[CSR] drives innovation and promotes learning, which help companies grow their business and increase their organization's value." *Id.*; *see also*, *CR Reporting enhances Financial Value*, KPMG (Nov. 7, 2011), http://kpmg.com/global/en/issuesandinsights/articlepublication/corporate-responsibility/pages/financial-value.aspx ("[M]any companies are now recognizing it as a business imperative. Today, companies are increasingly demonstrating that CR reporting provides financial value and drives innovation, reflecting the old adage of "what gets measured gets managed.").

94. *See supra* Part II; *see also* Rostain, *supra* note 19, at 480–84.

95. *See* Parker, *supra* note 1, at 346 (explaining that "[l]aw must be translated into training that makes sense to line managers and staff and where possible into operational procedures and principles that feed into what already happens"); *see generally* Caron, *supra* note 93; *see also* Richards, *New Compliance Rule*, *supra* note 17; 17 C.F.R. § 270.38a-1 (2012); Heineman, *supra* note 19, at 49.

> for compliance. We talk about what written standards and controls should be in place. We review the written standards and controls. We train around them, we communicate around those standards. We don't necessarily do the audit our selves, but we try to make sure that there's consistent auditing and evaluating of those standards that we have out there. And then, of course, we're responsible for the enforcement against it. So when we get the complaints that somebody is not following our code of conduct, we're the one that goes out and investigates them. We also are the ones that make sure that there is enforcement and consistent enforcement against it.[96]

Thus, a compliance officer needs to be a strong process manager to ensure consistency, coherence, and integration across the many departments.[97]

Additionally, compliance officers attempt to "raise awareness among employees that [the corporation has] policy and procedures that cover a lot of what they do" and that the employees are responsible "to be aware of them and claiming they are not aware when violating them is no defense—not a defense we accept. Our job is to raise awareness that there is an ethical obligation to be aware of what is allowed, which in the end is in the best interest of clients and that includes reporting if they see something that should not be done or could harm the company or clients."[98]

To that end, as the former chief compliance and ethics officer from Tyco stated, "[o]nce upon a time, the CCO narrowly focused on enforcement of regulatory requirements, codes of conduct, and corporate policies and procedures . . . . The biggest change in the job has been the integration of ethics into the compliance role."[99] Therefore, the compliance function oversees not just what is legally required but also that which the corporation has set as the ethical obligations and social responsibilities of the corporation.[100] As the chief compliance officer of a large public bank explained:

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96. Interviewee Stage 2 CCO6b at 3.

97. Heineman, *supra* note 19, at 49.

98. Interviewee Stage 2 CXO15 at 8.

99. Caron Carlson, *The Evolution of the Modern CCO*, Pari Center for New Learning (Feb. 20, 2008), http://www.paricenter.com/library/papers/boehme01.php (quoting Dave Danjczek, who was previously the CCO at Titan ("You can't have either 'ethics' or 'compliance' in your title; you need to have both."); *see also* Carlson, *supra* note 93 ("While the chief compliance officer role remains in flux, just about everyone in the business agrees on one point: It will probably never again be a simple matter of overseeing adherence to the rules."); Parker, *supra* note 1, at 340.

100. Parker, *supra* note 1, at 340; Parker, *supra* note 78, at 186. Chief compliance officers also advise on business and reputation risks. *See infra* note 338 and accompanying text. *See supra* note 37.

> We have one code of conduct that covers everyone. We strive for that. A lot of our culture is driven by the laws and regulations that govern our business . . . my job is to get people to A) at minimum do that—be aware of the laws and regulations and policies we have in place that ensure you are doing what is legally right and fulfilling and complying with all these rules and regulations and laws—at minimum [to get] everyone to comply with existing laws regulations and policies. B) The stretch and nice to have—the goal is to have them trained well enough and sensitized that something is permissible but not the right thing to do . . . the concept of doing the right thing—the right thing sometimes is more than the legal thing . . . you may be able to do it under the law but its not right for that client or business or for that employee.[101]

Compliance personnel are charged with communicating and providing training on the legal and ethical regulations to employees around the world.[102] They are also charged with risk assessment.[103] As another chief compliance officer elucidated, this international training is important not just to ensure compliance but "so that we can explain to the government, 'We did all we could: we went there, we were there in person, they got online training, we did risk assessments. This still happened, but this is how we try to show we have an effective Compliance Program.'"[104] Thus, in addition to audit and internal controls, training, ethics, and HR communications, compliance professionals need to understand politics.[105]

The substantive areas covered by a compliance department vary a great deal by industry.[106] Although some companies segment

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101. Interviewee Stage 2 CXO15 at 5.

102. *See* Parker, *supra* note 1, at 346; interviewee Stage 2 CCO6b at 10 ("We're so far-flung across the world and we're doing business in so many different places that it's very hard to know what you don't know and how things are going. And so we've got a major initiative this year to try not just to reach people online but also to reach many more people in person.").

103. *See, e.g.*, Ryan McConnell, *Teaching Compliance: How Law Schools Can Fight Unemployment*, CORP. COUN. (May 29, 2013), http://www.law.com/corporatecounsel/Pub Article CC.jsp?id=1202601883560&slreturn=20130602160053#.UaX9fV3kejM.mailto (listing leadership, communication, risk assessment, training, standards and controls, monitoring and response as the "building blocks for a compliance program"). PWC, DEEPER INSIGHT FOR GREATER STRATEGIC VALUE 5 (2013) [hereinafter PWC SURVEY] (finding that "CCOs are involved in risk areas," but that "increasingly ownership of those risks resides with the business").

104. Interviewee Stage 2 CCO5 at 11–12.

105. *See generally* Tabuena & Smith, *supra* note 85, at 13–15; *see also SCCE Study March 2013*, *supra* note 10, at 4 (quoting compliance professional survey respondent: "Legal's role is to protect and defend. Compliance's role is to uncover weaknesses, develop controls and mitigate risks. Uncovering weaknesses often poses a conflict within legal's role to protect").

106. For example, some sectors (like health care and financial services) are more heavily regulated and, therefore, have extra concerns. In the health care sector, a compliance officer must be concerned with HIPAA privacy law, Medicare, and the Food and Drug Administration

certain aspects of compliance (like health and safety) often, regardless of industry, compliance programs are fairly broad and cover many compliance areas at once.[107] As the chief compliance officer of a large pharmaceutical company explained:

> [y]ou can have regulatory compliance; you can have what's known as GxP, good manufacturing process, good lab practice, good clinical practice or process, compliance. It's just insanely it's a very, very broad area. I kind of—we call ourselves the Corporate Compliance Division here, because I like to put on the notion of, it's kind of the corporate compliance approach. It's the things that company has to do to make sure that it's in compliance with, not just kind of the laws and the regulations, but to a certain extent as well kind of society's expectation of us.[108]

Common substantive areas at issue for large publicly traded corporations are fraud and corruption (e.g., gifts, antibribery, anticorruption, antifraud, FCPA compliance, and data protection), employment/labor law, antitrust/trade regulation, environment/health and safety, and securities regulations.[109]

rules on top of the other regulatory and liability rules that apply to all publicly traded corporations. Carson, *supra* note 93; *see* interviews with health care professionals (on file with author). One Chief Compliance Officer in the health care field stated, "we focus on the federal healthcare program requirements; Medicare, Medicaid, TRICARE; those types of programs that are funded with taxpayer dollars. And we focus on eight distinct subject matter areas within that. And those are quality; making sure that our patients get good quality. Making sure that their services are medically necessary. Making sure that the providers that take care of them are qualified to do so. Making sure that their patient rights are protected, that the facility has the appropriate licensure and certification. Making sure that we document charge and bill for services correctly. Making sure that if we receive an overpayment in error, it's not our fault, but it's still not our money, that we give it back. Those are the focus areas that we work on and that's how we define a compliance issue." Interviewee Stage 2 CCO8 at 5.

107. Ford & Hess, *supra* note 2, at 694 ("Although compliance programs started out focused on specific issues, best practices now suggest that a single program should encompass the near entirety of a firm's efforts at compliance with laws and regulations.").

108. Interviewee Stage 2 CCO2 at 3–4.

109. *See* Parker, *supra* note 78, at 180–81 (citing survey research in support and explaining that in the Price Waterhouse Survey, the top eight areas of compliance programs included lobbying and government relations, international business practices, and intellectual property); *see also* Rostain, *supra* note 19, at 467 ("The emphasis on compliance pervades every sphere of corporate regulation, including environmental protection, occupational health, health care regulation, anti-terrorism legislation, and employment discrimination."). Interviews from the Compliance Study also support that these areas are among the top for some compliance officers. Evidently, the largest threat involving securities violations come from securities class actions as opposed to enforcement brought by the SEC or other regulatory agencies. TOM BAKER & SEAN J. GRIFFITH, ENSURING CORPORATE MISCONDUCT: HOW LIABILITY INSURANCE UNDERMINES SHAREHOLDER LITIGATION 3 (2011).

2. *Compliance Organization*

In terms of structure and organization at large publicly traded corporations, historically there has been a trend for compliance directors to report directly to the general counsel—or even to be the general counsel.[110] In a 2013 survey of 630 compliance professionals,

110. *See* Ford & Hess, *supra* note 2, at 693 (making this point and that sometimes the CCO also reports to the CEO); Rostain, *supra* note 19, at 481 (finding that most of the ten CCOs in her study reported to the general counsel); *see supra* note 10; *cf.* Langevoort, *supra* note 19, at 500 (describing the newer trend in large organizations to have CECO's with separate staff who report to the CEO). It is hard to generalize about the structure of compliance functions at corporations in general. *See supra* note 56 and accompanying text. This Article is focused on large publicly traded corporations. However, some of the surveys cited herein include data from both public and private companies and companies of different sizes. That said, in large publicly traded corporations, the trend appears to have been that the compliance officer reports to the general counsel. *See also* Roy Snell, *Greg Luce Talks About The Relationship Between Legal Counsel And Compliance Seasoned Veteran Discusses How Compliance Has Evolved And What It Takes To Be Effective*, 9 J. OF HEALTH CARE COMPLIANCE 31 (2007) ("Notwithstanding the preference of the Office of Inspector General (OIG) to separate the compliance and general counsel functions, many organizations include a report to the general counsel by the compliance officer."). Boheme, *infra* note 173. Also, according to the Compliance Study, some compliance officers report to the director of enterprise risk management, which generally focuses on identifying and assessing risks and opportunities related to the corporation's business objectives. *See, e.g,* Interviewee Stage 2 CCO7 at 3. ("[W]e've got our compliances [sic] under risk. It's separate from our legal counsel . . . . So what we've got is within risk, like I said, it's close to 300 people. We've got a pretty big active compliance unit of almost 70 people and the reason why our compliance unit is so big is we touch so many different compliance risk disciplines for [the company].") In some ways, this makes sense. Compliance is a form of risk management that focuses, in part, on assessing the risks of non-compliance, monitoring those risks, and creating prevention tactics. *See* Rachel Wolcott, *Time to Merge Risk Management and Compliance?*, REUTERS (Apr. 5, 2012), http://blogs.reuters.com/financial-regulatory-forum/2012/04/05/time-to-merge-risk-management-and-compliance/ (stating that compliance and risk management are very intertwined because essentially non-compliance is a risk, and considers whether companies should actually merge departments); *see also* David Martin & Mark R. Manley, *Linking Compliance, Risk Management*, 34 PENSIONS & INVESTMENTS 18 (2006), *available at* http://search.proquest.com/docview/222973834?accountid=14585 ("The effort to bring risk management and compliance together is far from finished. But our experience to date has taught us that convergence creates a more thoughtful, quality-oriented approach. When risk management and compliance are embedded in all business functions, processes are streamlined and business practices are clarified. This reduces compliance and regulatory risk and improves results for the clients; ultimately, it improves results for the firm."). Interestingly, in the last ten to fifteen years, law firms have begun to designate a firm lawyer as general counsel of the firm that oversees ethics and compliance. *See* Chambliss & Wilkins, *Compliance Specialists*, *supra* note 25 (analyzing the role in-house compliance specialists play in thirty-two law firms); *see also* Jaime Levy, *More Firms See Benefit of Using In-House General Counsel*, CHI LAW, at 28 (July 2004) (reporting that law firms are increasingly utilizing in-house counsel); Jonathan D. Glater, *In a Complex World, Even Lawyers Need Lawyers*, N.Y. TIMES, Feb. 3, 2004, at C1; Leigh Jones, *More Firms Hire General Counsel: GCs Help Reduce the Risk of Liability*, NAT'L L.J. (June 6, 2005); *see also* Elizabeth Chambliss, *The Nirvana Fallacy in Law Firm Regulation Debates*, 33 FORDHAM URB. L.J. 119, 129–32 (2005) (explaining that there is an emergence of compliance specialists and that they increasingly are the general counsel).

conducted by Corpedia, thirty-nice percent claimed they reported to the CEO while thirty-six percent claimed they reported to the general counsel.[111] In a 2010 survey by the Association of Corporate Counsel ("ACC"), more than half of respondents claimed the corporation had a chief compliance officer[112] and almost half of the 936 respondents claimed that compliance was ultimately overseen by the general counsel or that the general counsel was the chief compliance officer.[113] Similarly, in a survey conducted in 2005 by Corpedia and

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111. ACC & CORPEDIA, 2013 ACC/CORPEDIA BENCHMARKING SURVEY ON COMPLIANCE PROGRAMS AND RISK ASSESSMENTS (2013); Sue Reisinger, *ACC Study Sees Compliance Moving Out of the GC's Office*, CORPORATE COUNSEL (Oct. 15, 2013), *available at* http://www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202623517245&rss=rss_cc_mostviewed&slreturn=20130928004535.

112. According to other scholars and industry surveys, "[l]arger companies are more likely to have a chief compliance officer." *See* Ford & Hess, *supra* note 2, at 693 (citing Melissa Klein Aguilar, *CW Survey Shows Lack of CCO Standards*, COMPLIANCE WEEK, (April 29, 2008), http://www.complianceweek.com/pages/login.aspx?returl=/cw-survey-shows-lack-of-cco-standards/article/185601/&pagetypeid=28&articleid=185601&accesslevel=2&expireddays=0&accessAndPrice=0 and explaining that the "survey was an online survey of the readership of *Compliance Week* conducted during March 2008 with 284 usable respondents. The respondents were from corporations of a wide range of sizes and industries."); PWC SURVEY, *supra* note 103 at 5. ("[L]arger companies are more likely to have a CCO (88 for companies with more than $25 billion in annual revenues versus seventy three percent for companies in the $1–$5 billion range).").

113. *See* ACC & CORPEDIA, *supra* note 10, at 9; *See also* ETHISPHERE, THE BUSINESS CASE FOR CREATING A STANDALONE CHIEF COMPLIANCE OFFICER POSITION (2010), http://m1.ethisphere.com/resources/whitepaper-separation-of-gc-and-cco.pdf (assessing whether general counsel should also act as the compliance officer); *see also* Matt Kelly, et al., BROADER PERSPECTIVES; HIGHER PERFORMANCE. STATE OF COMPLIANCE: 2012 STUDY (2012), *available at* http://www.pwc.com/en_US/us/risk-management/assets/2012-compliance-study.pdf (finding that on a daily basis, thirty-five percent of compliance officers report to the general counsel and thirty-two percent report to the CEO. On a formal basis, thirty-two percent of compliance officers report to the audit committee, thirty-three percent to the general counsel, and twenty percent to the CEO). A 2007 survey by the Ethics and Compliance Officers Association found that thirty-two percent report to the CEO, fourty-one percent to the general counsel, and seven percent to the board. *Id.* at 18. A third study, conducted by the Conference Board in 2005 with 225 respondents, found similar results, with thirty-one percent of executives in charge of compliance reporting to the CEO, and 37 percent to the general counsel. RONALD E. BERENBEIM, CONFERENCE BOARD RESEARCH REPORT UNIVERSAL CONDUCT: AN ETHICS AND COMPLIANCE BENCHMARKING SURVEY 10–11 (2006). A 2010 survey with 481 responses conducted by the Society of Corporate Compliance and Ethics and the Health Care Compliance Association reported that at 48 percent of respondent corporations, the chief compliance officer reported directly to the board (although this does not mean that the CCO did not also report to the GC). HCCA & SCCE, *The Relationship Between the Board of Directors and the Compliance and Ethics Officer* (Apr. 2010), *available at*, http://www.compliancestrategists.net/sitebuildercontent/sitebuilderfiles/scce.survey.reporting.line2010.pdf. Additionally, it reported that there were more GC screening and editing of CCO reports before they are put to the board in publicly traded corporations than in privately held corporations or non-profits. *Id.* (reporting that thirty-five percent of publicly traded respondents answered that the reports by the CCO are "always or substantively edited by the general counsel or other executive" where as this was true for only fifteen percent of privately held company respondents and twelve of the non-profits). And a recent study by Society of Corporate Compliance and Ethics and the Health

the ACC of 412 corporate counsels, sixty-one percent of corporations had a chief compliance officer and forty-one percent of those corporate compliance officers also had the role of general counsel.[114]

The number of corporations in which the general counsel is also the chief compliance officer and in which the chief compliance officer reports to the general counsel appears to be decreasing.[115] For example, in a 2013 survey eliciting responses from over 800 private and public companies and non-profits in a database of the Health Care Compliance Association and Society of Corporate Compliance and Ethics, fifteen reported that the general counsel was also the chief compliance officer.[116] PwC's third annual survey of 800 corporate compliance officers,[117] reported that there has been a "steady reduction in formal reporting of compliance into the legal function over the past three years" (from thirty-seven percent of respondents in 2011 to thirty-three percent in 2012 to twenty-eight percent in 2013).[118] Further, in 2013, twenty-eight percent of chief compliance officer survey respondents reported to the General counsel and twenty-eight percent of the chief compliance officers reported directly the CEO (as opposed to only twenty percent in 2012).[119] This is consistent with reports from the Compliance Study. Eighty percent of thirty-six interviewees in Stage 1 but sixty-three

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Care Compliance Association reported that fifteen percent of 800 respondents reported that the same individual oversees legal and compliance. *SCCE Study March 2013*, *supra* note 10, at 6.

114. Association of Corporate Counsel & Corpedia, Inc., COMPLIANCE PROGRAM AND RISK ASSESSMENT BENCHMARKING SURVEY 2005, 8 (2005), *available at* http://media01.commpartners.com/acc_webcast_docs/Compliance_Survey.pdf; *see also* Corpedia and the Conference Board 2006, COMPLIANCE PROGRAM AND RISK ASSESSMENT BENCHMARKING SURVEY (2006) (surveying 225 inside corporate counsel and finding that 60 of all organizations have a Chief Compliance Officer and 38 of the chief compliance officers also reported being the general counsel); Judy Marras, *Surveys Offer Guidance for Future Compliance Officers*, SCCE, at 14 (Aug. 2006), http://www.corporatecompliance.org/Portals/1/PDF/Resources/Compliance_Ethics_Professional/0806/CnE0806_13_Marrs.pdf (discussing this survey and others); *see also*, Ethisphere, *supra* note 113, at 9 (claiming the chief compliance officer position is often housed in the legal department).

115. *See* Boehme, *infra* note 174; *SCCE Study March 2013*, *supra* note 10, at 6 (reporting results of approximately 800 responses from private, public, and non-profit companies from January and February 2013. Finding that 88.5 percent of respondents rejected the idea that the general counsel should also be the chief compliance officer, 80 percent opposed the idea of having compliance report to the general counsel, and only 15 percent of respondents reported having the general counsel also act as the compliance officer). Among 63 of the top 100 companies in the Fortune 100, 94 percent have a chief compliance officer and among those, 20 percent of the chief compliance officers also had the title of general counsel. *See* Appendix.

116. *SCCE Study March 2013*, *supra* note 10, at 6.

117. Survey participants were from the U.S. and the U.K. and spanned nineteen industries in companies whose revenue ranged from $200 million to $100 billion. PWC SURVEY, *supra* note 111 at 2.

118. PWC SURVEY, *supra* note 112, at 10.

119. *Id.* at 4, 9.

percent of the interviewees in stage two said that the general counsel had ultimate responsibility for the compliance function of their organizations. The remaining reported to the CEO, Chief Operating Officer, Chief Risk Officer, or no one person was in charge of compliance.[120]

3. Professional Skills of Compliance Officers

As others have pointed out, although the person that is in charge of compliance (and their training) varies by organization,[121] having a law degree is not a prerequisite to becoming a compliance professional at a corporation or becoming certified as a compliance and ethics professional through a university or organization certificate program.[122] Although the compliance function may involve legal expertise, it also requires skills in corporate management.[123] As

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120. It was not always the case that there was one person with the title CCO. Although some corporations did not have any one person in charge of compliance, some had various personnel that had been assigned compliance tasks despite not having any one person designated as CCO.

121. Ford & Hess, *supra* note 2, at 693 ("[T]here is no uniformity when it comes to whom the organization selects to be in charge of the compliance program."); *see* Langevoort, *supra* note 19, at 499–500 ("Business organizations have a great deal of freedom to choose their internal structures, and there is substantial variation as to the location of responsibilities relating to law, ethics, compliance, and risk management."); *see also supra* notes 6 and 56.

122. *See, e.g.*, *The Fordham Corporate Compliance Institute*, FORDHAM UNIVERSITY, http://law.fordham.edu/international-non-jd-programs/28994.htm (last visited June 27, 2013); *See also* Julie DiMauro, *Compliance Officers Face Multiple Options for Credentials*, REUTERS (May 17, 2012), http://blogs.reuters.com/financial-regulatory-forum/2012/05/17/compliance-officers-face-multiple-options-for-credentials/ (detailing courses and descriptions). In addition to Fordham, other law schools are offering classes (if not certification programs) in the compliance arena. *See, e.g.*, Ryan McConnell, *Teaching Compliance: How Law Schools Can Fight Unemployment*, CORP. COUN. (May 29, 2013), http://www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202601883560&slreturn=20130602160053#.UaX9fV3kcjM.mailto (discussing teaching corporate compliance at University of Houston Law Center).

123. Parker, *supra* note 1, at 339; *id.* at 346 ("Compliance is a management issue, not a legal one."). *See, e.g.*, Rostain, *supra* note 19, at 480 (hypothesizing that corporate counsel may oversee compliance and "[t]o fulfill this function, lawyers will need to develop a hybrid expertise that marries legal knowledge and managerial techniques."). It may be that lawyers approach the role of compliance officer differently than nonlawyers. Parker, *supra* note 78, at 182–83 ("New compliance professionals claim an expertise that is superior to that of traditional lawyers, particularly external lawyers, in implementing and facilitating compliance programs as a matter of corporate management rather than legalism."). *See* Ford & Hess, *supra* note 2, at 693 (citing studies in support of this claim); *See also* Parker, *supra* note 78, at 183 (contending that corporate lawyers treat regulatory law "as a symbolic regime of technical rules independent of business to be managed and manipulated to suit client, or imposed as procedural constraints upon corporate management" whereas compliance professionals have a "less autonomous, more business responsive formulation of its own role" that is more pragmatic); *id.* at 183–88 (comparing how compliance professionals describe their work to how lawyers do so). However, analyzing the pros and cons of compliance professionals having formal training as lawyers is outside the scope of this Article and a subject of a future article. *See supra* note 24.

mentioned above—and as Parker's research demonstrates—"a new 'compliance profession' is beginning to emerge as evidenced by the growth of professional associations, conferences and training courses catering specifically to their needs."[124] Historically, regulation and compliance oversight has been managed by in-house lawyers and to a large degree that is still true today.[125] The secondary literature (along with reports from the Compliance Study) indicate that compliance departments at large corporations—regardless of where the departments are housed—are made up of a lot of people that originally were trained in and practiced law.[126] However, this new field may not necessarily be owned by lawyers in the future and may still be up for grabs. As others have commentated, "[t]he growth of

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124. Parker, *supra* note 1, at 339; Parker, *supra* note 78, at 181–83 (reporting the number of new professional associations and backgrounds of compliance professionals).

125. Rosen, *supra* note 8, at 487 (demonstrating that compliance oversight is central to the in-house lawyer's job); Parker, *supra* note 1, at 339 ("Inhouse corporate lawyers are claiming the area of preventative law as their own."); Donna Boehme, *JPMorgan Chase Takes a Giant Step on CCO Independence*, CORP. COUN. (Jan 29, 2013), http://www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202586012597&JPMorgan_Chase_Takes_a_Giant_Step_on_CCO_Independence. Donna Boehme, *Big Banks Giving the CCO a Seat at the Table*, CORP. COUN. (Mar. 1, 2013), http://www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202590410783&Big_Banks_Giving_the_CCO_a_Seat_at_the_Table&slreturn=20130607091253 (explaining that pharmaceutical companies, which historically subordinated the CCO to the GC, began leveling the playing field by including in their health care settlement agreements, that CCOs would not be subordinate to the GC and that this is now also beginning to occur at large banks); Richard S. Gruner, *General Counsels in an Era of Compliance Programs and Corporate Self-Policing*, 46 EMORY L.J. 1113, 1114–15 (1997); Parker, *supra* note 78, at 183 ("[T]he legal profession will try to control regulatory space with a conception of legalism in which the autonomy of law is highly significant"). There might be a role for outside attorneys to help corporate clients manage compliance and, therefore, this burgeoning field may represent an opportunity for law firms to add value. *But see* Parker, *supra* note 1, at 349 (emphasizing the importance of being an insider in order to have persuasive power in compliance). However, analyzing the role outside attorneys might play in helping corporate clients manage compliance is outside the scope of this Article. *See supra* note 24.

On another note, one argument in support of departmentalization that I have not found in the literature but was introduced to me by William H. Widen is that departmentalizing compliance from the legal function mirrors the organizational structure found in law firms—which typically have a litigation department and a corporate department. If the general counsel's office in corporations tends to have more of a litigation focus, it could be that that compliance expertise is structurally lacking in the legal departments of corporations. If the corporate departments of large law firms are where more of the compliance expertise is housed, this would support an argument for a corporation to set up a separate compliance department. The compliance department within a corporation would be the analog to the corporate department in a large law firm. Further, this could explain why regulators are gravitating to creating separate compliance departments—perhaps even unconsciously. It feels familiar. However, as Widen pointed out in our discussion, just because it is familiar does not mean that it is the correct path to take. There are differences between the law firm and the corporation. For example, whether the work involves litigation or a business deal, a law firm's work is, essentially, transactional. The law firm is not attempting to foster a compliance culture.

126. Parker, *supra* note 1, at 339. *See* Ford & Hess, *supra* note 2; *cf* Parker, *supra* note 78, at 181. Wilkins, *Rivals*, *supra* note 49, at 2131–32 (citing Tanina Rostain for this proposition).

compliance professionalism presents the potential for breaking down part of the legal professional field and opening a new 'regulatory field.'"[127]

III. THE GOVERNMENT'S RESPONSE TO CORPORATE WRONGDOING: DEPARTMENTALIZING COMPLIANCE FROM THE LEGAL DEPARTMENT

From Madoff to AGI to Goldman Sachs and more recently Wal-Mart and JP Morgan, the past fifteen years have witnessed a slew of corporate misconduct spanning industries that have devastated the public's faith in corporate compliance with the law.[128] Further, there has been an influx of regulations across industries that increase liability and penalties and provide incentives to corporations to voluntarily adopt compliance and ethics programs focused on monitoring and prevention.[129]

As discussed, in recent history, in large, publicly traded corporations, the compliance function has been a part of the legal department or at least overseen by the general counsel.[130] Although the SEC and other governmental agencies do not require that corporations separate the compliance and legal functions, it seems as though their unofficial stance is that they should. Recently, the OIG of the SEC and DHHS have forced corporations that have misbehaved to do just that, to develop a distinct compliance department and designate a chief compliance officer that does not report to the general counsel but instead to the CEO with direct

127. Parker, *supra* note 78, at 182–83; *id.* at 186 ("[C]ompliance professionalism poses a challenge to legal professionalism by making compliance advice and application the province of a variety of people within the company with different skills and with responsibilities at all levels."). For further discussion of areas where lawyers compete with nonlawyers and potential violations of practice of law statutes, *see* DeStefano, *supra* note 89.

128. MAX H. BAZERMAN & ANN E. TENBRUNSEL, BLIND SPOTS: WHY WE FAIL TO DO WHAT'S RIGHT AND WHAT TO DO ABOUT IT 3 (2011). *See supra* note 11; Barstow, *supra* note 8 (describing the corporate scandal of WalMart de Mexico, where the company allegedly spent millions of dollars on bribes to obtain permits across Mexico in order to dominate the market); Donna Boehme, *JP Morgan Chase Learns It's Not Too Big to Comply*, CORP. COUN. (Sept. 20, 2013), http://www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202619981159 (describing JP Morgan's recent announcement to spend $4 billion on compliance efforts including hiring 5,000 extra employees and replacing the chief compliance officer and separating the function from the legal department).

129. *See* Parker, *supra* note 1, at 339 (making similar point and listing the various regulatory regimes that provide incentives for corporations to voluntarily adopt compliance structures); *see, e.g.*, Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). *See supra* notes 1, 17, and 37.

130. *See supra* Part II and note 110. Note, this Article does not analyze why compliance is overseen by someone in the legal department at so many corporations.

access to the board.[131] Other corporations (those that have *not* been investigated) have followed suit, spending millions of dollars developing compliance structures including codes of conduct, training programs, monitoring and detection procedures and policies,[132] and building separate compliance departments.[133]

This Part is divided in two sections. Section A begins by exploring a few examples of companies that have been investigated by the government and, as part of their consent decrees, deferred prosecution agreements, or non-prosecution agreements, have agreed to separate out the compliance function from the legal function and/or designate an executive as a chief compliance officer with some type of direct reporting to the board. Section B compares the position taken by the government in these agreements to recommendations and requirements found in other regulations, and guidelines created by the Federal Sentencing Commission, the government, and the ABA. The discussion is fairly descriptive and seeks to show a common stance taken by governmental entities in negotiating agreements around compliance oversight and that this recent stance differs from that found in other guidelines and regulations, which support general counsel oversight of compliance departments and/or require that general counsels play a gatekeeping role.

131. They have also issued guidelines recommending this. For example, the OIG of the DHHS recommends that hospitals separate the compliance and legal departments and establish a direct reporting relationship between compliance and the board of directors. Publication of the OIG Compliance Program Guidance for Hospitals, 63 Fed. Reg. 35, 8987, 8989 (Feb. 23, 1998), *available at* http://www.oig.hhs.gov/authorities/docs/cpghosp.pdf. For background, *see* United States *ex rel.* Lam v. Tenet Healthcare Corp., 287 Fed. Appx. 396 (5th Cir. 2008).

132. Bazerman and Tenbrunsel, *supra* note 128, at 3; *id.* at 102 (explaining that the compliance "initiatives don't come cheap. A recent survey of 217 large firms indicated that for every billion dollars in revenue earned, the average company spends one million dollars on compliance initiatives."). Harry Hurt III, *Drop That Ledger! This is the Compliance Officer*, N.Y. TIMES, May 15, 2005, *available at* http://www.nytimes.com/2005/05/15/business/yourmoney/15comply.html?pagewanted=all&_r=0 ("A recent survey of 217 big companies by Financial Executives International, a professional association, estimated the annual costs of complying just with the internal controls section of Sarbanes-Oxley at almost $1 million per $1 billion in revenue."); *id.* (reporting that executives at Sun Microsystems estimate compliance costs exceed $6 million a year "if the figure included the time employees spent on compliance training, auditors' and accountants' fees, and costs incurred by the corporate controller's office."). Also, because corporate noncompliance can ruin a company's reputation and be very costly, corporations may be over inclusive when it comes to training initiatives and deciding whom to train. *Id.* *See infra* note 240.

133. *See supra* notes 17 and 37.

A. GOVERNMENT AGREEMENTS REQUIRING CORPORATIONS TO DEPARTMENTALIZE COMPLIANCE

Whether it is the result of more corporations misbehaving than in the past, the passing of more regulations (e.g., the Dodd-Frank Act), or simply an increase in public emphasis and scrutiny over corporate malfeasance, it appears that more and more publicly traded corporations are getting into trouble with the government for failing to comply with regulations.[134] Indeed, since 1986, settlements and judgments for violations (or alleged violations) of just the False Claims Act alone totaled over $25 billion.[135]

1. *Example 1: Schering-Plough*

In 2004, the Schering-Plough Corporation, one of the largest pharmaceutical manufacturers in the world, agreed to plead guilty to fraud in relation to pricing information it provided (or failed to provide) to Medicaid for its drug Claritin.[136] Evidently, believing that Claritin was too expensive, two health maintenance organizations ("HMOs") threatened to replace Claritin with Allegra on their list of covered drugs.[137] To discourage the HMOs from doing so, Schering-Plough allegedly paid the HMOs millions of dollars in discounts via data fees, interest free loans, and rebates.[138] Reputedly, Schering-

134. *Cf.* Hannah D'Apice, *Is the SEC's Recent Run of High-Profile Prosecutions a Flash in the Pan?*, CORP. COUN. (July 21, 2011) ("In the wake of the recent financial crisis and the passing of the Dodd-Frank Act, corporate oversight is being done through an ever-sharper microscope. Now that the Securities and Exchange Commission has gotten expanded authority to oversee Wall Street, internal missteps seem to be getting more and more expensive."). Also, corporate fraud has been predicted to be on the rise. *See, e.g.*, THE NETWORK, INC., 2013 CORPORATE GOVERNANCE AND COMPLIANCE HOTLINE BENCHMARKING REPORT 6 (2013), *available at* http://www.tnwinc.com/reports/2013-TNW-Corporate-Governance-and-Compliance-Hotline-Benchmarking-Report.pdf?utm_source=Form+Submission+Confirmation&utm_medium=Landing+Page&utm_content=2013+Benchmarking+Report&utm_campaign=Report+Accessed+-+2013+Benchmarking+Report (indicating that hotline incident reports for corporate fraud rose in 2012 to higher than it was in 2005); Sue Reisinger, *Survey Sees Rise in Corporate Fraud Hotline Reports*, CORP. COUN. (Aug. 16, 2013), http://www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202615685805.

135. U.S. DEP'T OF JUSTICE, FRAUD STATISTICS – OVERVIEW (2012), *available at* http://www.taf.org/DoJ-FCA-statistics-2012.pdf.

136. TAXPAYERS AGAINST FRAUD, TOTAL FY 2004 FALSE CLAIM ACT FRAUD SETTLEMENTS & JUDGMENTS (2004), *available at* http://www.taf.org/total2004.htm. Claritin, an allergy medicine, was Schering-Plough's best-selling drug and significantly costlier than Allegra, a competitor's similar product. Press Release, Dep't of Justice, Schering-Plough to Pay $345 Million to Resolve Criminal and Civil Liabilities for Illegal Marketing of Claritin (July 30, 2004), http://www.justice.gov/opa/pr/2004/July/04_civ_523.htm [hereinafter *Schering-Plough Press Release*].

137. *See Schering-Plough Press Release*, *supra* note 136.

138. *Id.*

Plough failed to report these price discounts to the Medicaid program, violating a provision in the Medicaid Rebate Statute that required the company to offer to sell the drugs to Medicaid at a price that was equal to the best price charged commercial customers. [139] Reportedly, Schering-Plough pled guilty to one count of offering and paying a kickback in violation of the Anti-Kickback Statute.[140] Further, it paid more than $290 million in settlement[141] and assented to a five-year corporate integrity agreement ("CIA") with the DHHS's OIG.[142] In addition to mandating that the company establish a reporting hotline, develop employee training, and revamp the written codes of conduct,[143] the CIA required the company to designate a chief compliance officer who would report directly to the Chairman, CEO, and President of the company. [144] It also mandated that the chief compliance officer "shall not be or be subordinate to the general counsel or chief financial officer." [145] Additionally, the CIA required the company to hire an outside monitor to oversee implementation of the CIA.[146]

2. *Example 2: Quest Diagnostics*

In October 2004, the SEC[147] charged Quest Diagnostics with fraudulently projecting over $3.8 billion in revenue earnings in a

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139. *See Schering-Plough Press Release, supra* note 136.

140. 42 U.S.C. § 1320a-7b (2012). *See Schering-Plough Press Release, supra* note 135; *Allegations of Waste, Fraud, and Abuse in Pharmaceutical Pricing: Financial Impacts on Federal Health Programs and the Federal Taxpayer: Hearing Before the H. Comm. on Oversight and Gov't Reform,* 110th Cong. 110-4 (2007) (statement of James W. Moorman, President and CEO, Taxpayers Against Fraud).

141. TAXPAYERS AGAINST FRAUD, *supra* note 136.

142. *See* Schering-Plough Corporate Integrity Agreement, Office of the Inspector General of the Dep't of Health and Human Services (July 29, 2004), *available at* http://www.taf.org/settlements.htm. Evidently, "[i]nvestigators found evidence that Schering-Plough marketed drugs for off-label uses."
Schering-Plough Pleaded Guilty to Conspiracy Fined $435 Million for Promoting Off-Label Use, ALLIANCE FOR HUMAN PROTECTION (Aug. 30, 2006), http://www.ahrp.org/cms/content/view/331/150/.

143. *See* Schering-Plough Corporate Integrity Agreement, *supra* note 142, at 7–11 (codes); 11–15 (training); 21 (hotline).

144. *Id.* at 6.

145. *Id.* 5–6.

146. *Id.* at 16.

147. The U.S. Securities and Exchange Commission "is the federal agency that administers the federal laws governing the U.S. securities markets." U.S. SEC. & EXCH. COMM'N, 2005 PERFORMANCE AND ACCOUNTABILITY REPORT 3 (2005), *available at* http://www.sec.gov/about/secpar2005.shtml. In 2005, the SEC conducted 947 investigations and 629 civil and administrative proceedings. *Id.* at 7. It prevailed in more than half of its enforcement actions and negotiated more than $3 billion in disgorgement and other penalties. *Id.* During that year, it brought several fraud cases involving mutual funds and investment advisers,

"multifaceted fraudulent scheme to meet optimistic and unsupportable revenue and earnings projections."[148] In settling the case, Quest agreed to pay a $250-million civil penalty[149] and to revamp its code of conduct[150] and training programs.[151] Further, the CIA required that Quest create a Chief Compliance Officer position and that the "Compliance Officer shall not be or be subordinate to the General Counselor Chief Financial Officer,"[152] but instead would "report directly to Quest's CEO . . . [and] make periodic (at least quarterly) reports regarding compliance matters directly to the Quality, Safety, and Compliance Committee [("QSC")] of the Quest Diagnostics Board of Directors . . . ."[153] Additionally, the CIA mandated that Quest hire an independent compliance expert to review and oversee its compliance program.[154]

3. *Example 3: Pfizer*

In August 2009, Pfizer Inc., the largest pharmaceutical manufacturer in the world, entered into the largest healthcare fraud settlement in history for illegally promoting several of its drugs, including Bextra, for uses that were not specifically approved by the Federal Drug Administration ("FDA").[155] Pfizer paid $2.3 billion

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accounting fraud, disclosure and auditing failures and cases against self-regulatory organizations like the New York Stock Exchange ("NYSE") and the Nationals Stock Exchange ("NSX"). *Id.* at 8–10.

148. Quest Diagnostics Inc. Corporate Integrity Agreement, Office of the Inspector General of the Dep't of Health and Human Services 4 (2009), *available at* http://oig.hhs.gov/compliance/corporate-integrity-agreements/cia-documents.asp#q.

149. U.S. SEC. & EXCH. COMM'N, *supra* note 146, at 7.

150. *Id.* at 9.

151. *Id.* at 11–12.

152. Quest Diagnostics Inc., Corporate Integrity Agreement, *supra* note 148.

153. *Id.*

154. *Id.* at 6–7.

155. Pfizer Inc. Corporate Integrity Agreement, Office of the Inspector General of the Dep't. of Health and Human Services 35 (Aug. 31, 2009), *available at* http://oig.hhs.gov/fraud/cia/agreements/pfizer_inc_08312009.pdf. In the United States, doctors are allowed to prescribe any FDA approved drugs at their discretion, but the manufacturers cannot market their drugs to doctors for unapproved (so-called "off-label") reasons. *The Enforcement of the Criminal Laws Against Medicare and Medicaid Fraud: Hearing Before the H. Judiciary Subcomm. on Crime, Terrorism, and Homeland Security*, 111th Cong. 111-113 (2010) (statement of Mark Collins, Director of the Nebraska Medicaid Fraud Control Unit, Nebraska Att'y Gen.'s Office; Special Assistant U.S. Att'y, District of Nebraska for health care fraud matters; and President, National Association of Medicaid Fraud Control Units). For example, Pfizer allegedly "encouraged doctors [with dinners, subsidized travel, inflated payments for speaking engagements] to prescribe Bextra for off-label uses such as acute pain," when the FDA only formally approved it for treating types of arthritis and intense menstrual pain. Jonathan D. Rockoff and Brent Kendall, *Pfizer to Plead Guilty to Improper Marketing*, WALL ST. J., Sept. 3, 2009, *available at* http://online.wsj.com/article/SB125190160702979723.html.

and pled guilty to a felony criminal violation of the Federal Food, Drug, & Cosmetic Act and signed a five year CIA.[156] In addition to mandating a hotline,[157] heightened training,[158] and specific provisions in Pfizer's code of conduct,[159] the CIA required that the company designate a "Chief Compliance Officer [who] shall not be, or be subordinate to, the General Counsel or chief financial officer."[160] The agreement also stipulated that Pfizer hire an independent review organization to monitor compliance with the CIA's requirements.[161]

4. Example 4: SEC

Ironically, in 2009, the FBI began criminal investigations into the SEC itself for possible insider trading by two SEC attorneys.[162] The OIG of the SEC alleged that two SEC attorneys sold their stock in companies that they knew were going to be investigated, a "direct violation of SEC rules."[163] According to the March 2009 inspector general report, at the time of the alleged insider trading, the compliance function at the SEC was disjointed and housed in two different departments.[164] Disconcertingly, the OIG report concluded that the SEC "lack[ed] any true compliance system to monitor SEC employees' securities transactions,"[165] that SEC employees did not

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156. Pfizer Inc. Corporate Integrity Agreement, *supra* note 155, at 35–36. Just this past year Amgen Inc. was prosecuted for its drugs for "off-label" uses at doses doses not approved by the Food and Drug Administration—pled guilty plea for $762 million. Angela Hunt, *Big Pharma Under the Compliance Microscope*, CORP. COUN. (Oct. 24, 2013).

157. *Id.* at 22.

158. *Id.* at 14–15.

159. *Id.* at 7.

160. *Id.* at 4.

161. *Id.* at 17.

162. Laura Strickler & Armen Keteyian, *SEC Attorneys Probed For Insider Trading*, CBS NEWS, May 15, 2009, *available at* http://www.cbsnews.com/stories/2009/05/14/cbsnews_investigates/main5014672.shtml ("It's hard to imagine a more serious violation of the public trust than for the agency responsible for protecting investors to allow its employees to profit from non-public information about its enforcement activities," quoting Grassley's letter to Schapiro).

163. *Id.*

164. U.S. SEC. & EXCH. COMM'N, CASE NO. OIC-481,EMPLOYEES' SECURITIES TRANSACTIONS RAISE SUSPICIONS OF INSIDER TRADING AND CREATE APPEARANCES OF IMPROPRIETY; VIOLATIONS OF FINANCIAL REPORTING REQUIREMENTS; AND LACK OF SEC EMPLOYEE SECURITIES TRANSACTIONS COMPLIANCE SYSTEM 47–49 (2009), *available at* http://pogoarchives.org/m/fo/sec-oig-report-20090303.pdf. Melissa Kelin Aguilar, *SEC Strengthens Rules on Staff Securities Trading*, COMPLIANCE WEEK (May 26, 2009), http://www.complianceweek.com/sec-strengthens-rules-on-staff-securities-trading/article/18718/ ("[R]esponsibility within the SEC for ensuring staff compliance was split between two offices.").

165. U.S. SEC. & EXCH. COMM'N, *supra* note 163, at 8. The department heads that were officially in charge of overseeing ethics and compliance "admitted that that there [was] 'no true compliance' system at the SEC for determining whether SEC employees have committed Rule 5 violations." *Id.* at 48.

understand reporting requirements or who was in charge of overseeing ethics and compliance,[166] and that there was "lax enforcement of the reporting requirements."[167] The report recommended that the SEC ensure that one department be vested with primary responsibility over compliance. And in response, the SEC consolidated the compliance department under the Office of Ethics Counsel and hired its first ever, chief compliance officer.[168] This department, however, remained a part of the Office of General Counsel until late 2011.[169] After the SEC's general counsel was named as one of the defendants in a Madoff bankruptcy suit, the OIG criticized the SEC for having the ethics counsel report to the general counsel.[170] In response, the SEC "formally proclaimed the

166. *Id.* at 47 (stating that "no one [the OIG] interviewed was clear as to which office had responsibility" to ensure compliance or review filings related to the alleged violation).

167. U.S. SEC. & EXCH. COMM'N, *supra* note 163, at 51. *Id.* at 48. (finding that there were no checking or monitoring systems in place, "[e]mployees [we]re expected to comply with the financial disclosure and clearance systems . . . based on the honor system").

168. In response, the SEC stated that the IG report does not accuse nor conclude that any SEC employee conducted insider trading and that it had "been taking additional steps to enhance [the] protections against the potential for improper conduct. Those include developing a new computer system to facilitate reporting and review of securities trading by all SEC personnel; hiring a chief compliance officer; and providing greater clarity of our rule governing the reporting of trades." Strickler & Keteyian, *supra* note 162. Aguilar, *supra* note 163 ("In addition, SEC Chairman Mary Schapiro has signed an order consolidating responsibility for oversight of employee securities transactions and financial disclosure reporting within the Ethics Office and authorized the hiring of a new chief compliance officer."); Matt Kelly, *The Big Picture*, COMPLIANCE WEEK (Apr. 9, 2010), http://www.complianceweek.com/chief-compliance-officers-sec-style/article/189690/ (reporting that Kathleen "Griffin is the SEC's first-ever chief compliance officer, and her arrival is long overdue" and arguing that the problem is that Griffin is not independent and does not report to the Chairman). Despite these efforts, the SEC continues to get lambasted in the press about its ethical culture and ability to ensure compliance, especially around its handling of the Bernard Madoff fraud Ponze scheme. *SEC Big Grilled on Ethics Issues*, N.Y. POST, Sept. 23, 2011, *available at* http://www.nypost.com/p/news/business/sec_big_grilled_on_ethics_issues_stId4S1sQxyEEuHuxwBseO.

169. It was reported that "[o]n October 14, 2011, pursuant to Section 1 of Reorganization Plan No. 10 of 1950, the Chairman implemented that recommendation [of the OIG] and made the Office of the Ethics Counsel a stand-alone Office of the Commission." Reporting Line for the Commission's Exchange Act, Release No. 34-65742, (2011), *available at* http://www.sec.gov/rules/final/2011/34-65742.pdf. As of August 6, 2013, the Office of Ethics Counsel is separated from the Office of General Counsel on the SEC's website. *Office of Ethics Counsel*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/about/offices/ethics.shtml (last visited Aug. 6, 2013); *Office of the General Counsel*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/about/offices/ogc.htm (last visited Aug. 6, 2013). However, as of December 17, 2011, the Office of Ethics Counsel was still listed as part of the Office of the General Counsel on the SEC's website. *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/about/whatwedo.shtml (last visited Dec. 17, 2011). As of September 5, 2013, it is not clear from the website to whom the Office of the Ethics Counsel reports.

170. U.S. SEC. & EXCH. COMM'N, CASE NO. OIG-560 REPORT OF INVESTIGATION: INVESTIGATION OF CONFLICT OF INTEREST ARISING FROM FORMER GENERAL COUNSEL'S PARTICIPATION IN MADOFF-RELATED MATTERS 7 (2011), *available at* http://www.sec.gov/foia

independence of its Office of Ethics Counsel as a stand-alone unit within the agency."[171] Resultantly, the head of this office no longer reports to the General Counsel but instead to the SEC Chairman.

B. GUIDELINES AND RULES SUPPORTING GENERAL COUNSELS AS COMPLIANCE GATEKEEPERS

As exemplified above, when corporations get in trouble for noncompliance, government entities (such as the OIG of the SEC and of the DHHS) emphasize the formal structure, management, policies, and programs of compliance at organizations. And more specifically, a common recommendation is for the allegedly malfeasant organization to separate the compliance function from the legal department, designate a chief compliance officer who is not also the general counsel (and that does not report to the general counsel), and enable direct reporting to the CEO and/or direct reporting or at least direct access to the board of directors.[172] Unsurprisingly, this view is similar to that taken by many compliance related organizations of private entities and audit, compliance, and governance executives who arguably are self-interested.[173] It is also consistent with surveys of compliance professionals.[174] However, a preference for stand-

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/docs/oig-560.pdf; Bruce Carton, *SEC IG Releases Report on Becker Conflict Issue, Refers Results to DOJ's Public Integrity Section,* COMPLIANCE WEEK, (Sept. 16, 2011), http://www.complianceweek.com/sec-ig-releases-report-on-becker-conflict-issue-refers-results-to-dojs-public-integrity-section/article/212434/.

171. Reese Darragh, *SEC Ethics Office Shakeup,* COMPLIANCE WEEK, (Dec. 15, 2011), http://www.complianceweek.com/sec-ethics-office-shakeup/article/216792/.

172. The OIG Compliance Program Guidance for Hospitals, developed by the Department of Health and Human Services of the Federal Register also recommends an independent compliance function. Publication of the OIG Compliance Program Guidance for Hospitals, 63 Fed. Reg. 8987, 8993 (Feb. 23, 1998), *available at* https://oig.hhs.gov/authorities/docs/cpghosp.pdf. OIG Supplemental Compliance Program Guidance for Hospitals, 70 Fed. Reg. 4858, 4874 (Jan. 31, 2005), *available at* http://oig.hhs.gov/fraud/docs/complianceguidance/012705HospSupplementalGuidance.pdf.

173. Kelly, *supra* note 167. For example, the Institute of Internal Auditors (IIA), a guidance-setting body serving members in 165 countries, stresses the importance of an independent compliance department. Tabuena, *supra* note 56, at 2 (stating that the Code of ethics for health care compliance (HCCA) stresses the importance of an independent compliance function).

174. *See, e.g., SCCE Study March 2013, supra* note 10 (finding that eighty percent of 800 compliance and ethics professionals were opposed to having the general counsel serve as chief compliance officer). *Id.* (finding that eighty percent overall were opposed to having the compliance function report to the legal department but only seventy-four percent of those working for publicly traded companies were opposed). Kelly, *supra* note 167. Donna Boehme, *Making the CCO an Independent Voice in the C-Suite,* CORP. COUN. (Mar. 19, 2013), http://www.law.com/corporatecounsel/PubArticleCC.jsp?id=1202592518804&Making_the_CCO_an_Independent_Voice_in_the_CSuite. MICHAEL D. GREENBERG, PERSPECTIVES OF CHIEF ETHICS AND COMPLIANCE OFFICERS ON THE DETECTION AND PREVENTION OF CORPORATE MISDEEDS: WHAT THE POLICY COMMUNITY SHOULD KNOW 13 (2009), *available at*

alone, independent compliance departments is not necessarily consistent with the recent federal sentencing guidelines, sections of Sarbanes-Oxley, nor the historical position taken by the ABA, all of which allow, recommend, or require that the general counsel be a compliance gatekeeper.

1. *Federal Sentencing Guidelines*

Before 2010, the Federal Sentencing Guidelines[175] defined an "effective" compliance program as one that designated overall responsibility for the compliance and ethics program to specific high-level personnel.[176] In 2010, the United States Sentencing Commission revised its guidelines regarding, among other things, compliance issues.[177] The revised guidelines provide leniency to companies who not only allocate appropriate authority to compliance personnel, but also give them "direct access" to the board of directors.[178] Further, the guidelines clarify that the presumption that an organization's compliance program *is not* effective if "high-level personnel" were responsible for, willfully ignorant, or condoned the misconduct,[179] can

http://www.rand.org/pubs/conf_proceedings /CF258. MICHAEL D. GREENBERG, DIRECTORS AS GUARDIANS OF COMPLIANCE AND ETHICS WITHIN THE CORPORATE CITADEL: WHAT THE POLICY COMMUNITY SHOULD KNOW 11 (2010), *available at* http://www.rand.org/pubs/conf_proceedings/CF277.html (reporting statements by chief compliance officers at a recent conferences on compliance sponsored by the RAND institute).

175. The United States Sentencing Commission ("USSC") develops the United States Sentencing Guidelines, which used to be mandatory but are no longer mandatory given a 2005 ruling by the Supreme Court. *An Overview of the United States Sentencing Commission*, U.S. SENTENCING COMM'N, at 2, *available at* http://www.ussc.gov/About_the_Commission/Overview_of_the_USSC/USSC_Overview.pdf (last visited Oct. 27, 2013). United States v. Booker, 543 U.S. 220 (2005). These guidelines only apply in cases being heard in federal courts. *Id.* FAMILIES AGAINST MANDATORY MINIMUMS, *U.S. Sentencing Guideline Amendments in a Nutshell* (2012), *available at* http://www.famm.org/FederalSentencing/USSentencingGuidelines/USSentencingGuidelinesUpdates.aspx.

176. U.S. SENTENCING GUIDELINES MANUAL (Proposed Amendments 2010), *available at* http://www.ussc.gov/Legal/Amendments/Reader-Friendly/20100121-RFP-Amendments.pdf; U.S. SENTENCING GUIDELINES MANUAL § 8B2.1 (2009).

177. *Id.* at 33.

178. J. Brady Dugan & Catherine E. Creely, *Sentencing Guideline Amendments: What Impact on Regulated Enterprises?*, 25 LEGAL BACKGROUNDER 1, 2 (2010). This essentially means that this person has express authority to report to the board directly about any potentially criminal matter and does so annually. *See* U.S. SENTENCING GUIDELINES MANUAL (Proposed Amendments 2010), *available at* http://www.ussc.gov/Legal/Amendments/Reader-Friendly/20100121-RFP-Amendments.pdf; *see* U.S. SENTENCING GUIDELINES MANUAL § B2.1(b)(2)(C). Additionally, the following comments were added to the section that describes what is an effective compliance program: "The organization may take the additional step of retaining an independent monitor to ensure adequate assessment and implementation of the modifications." Sentencing Guidelines for United States Courts, 75 Fed. Reg. 3525, 3539 (Jan. 21, 2010).

179. Dugan and Creely, *supra* note 178, at 2.

be rebutted if, among other things, "the individual or individuals with operational responsibility for the compliance and ethics program (have direct reporting obligations to the governing authority or an appropriate subgroup thereof (e.g., an audit committee of the board of directors)."[180] However, there is no requirement that the compliance *director not* report to the general counsel. Indeed, the compliance officer can report to the general counsel and can even *be* the general counsel as long as the alternative reporting line is also provided.[181] Thus, although the sentencing guidelines emphasize the importance of having a chief compliance officer, unlike the CIAs discussed above, this emphasis is not on independence of the compliance function (from the legal function) but instead on ensuring board of director oversight.

2. *The ABA*

There has been much debate among lawyers and academics in the legal profession about whether lawyers should play the role of gatekeeper[182] and whether outside or inside lawyers are better able and situated to playing that role.[183] However, the notion that lawyers

180. U.S. SENTENCING GUIDELINES MANUAL (Proposed Amendments 2010), *available at* http://www.ussc.gov/Legal/Amendments/Reader-Friendly/20100121-RFP-Amendments.pdf; U.S. SENTENCING GUIDELINES MANUAL § 8B2.1 (2009) (including as requirements to rebut the presumption: that "the compliance and ethics program detected the offense before discovery outside the organization or before such discovery was reasonable likely; the organization promptly reported the offense to appropriate governmental authorities; and no individual with operational responsibility for the compliance and ethics program participated in, condoned, or was willfully ignorant of the offense.").

181. U.S. SENTENCING GUIDELINES MANUAL, § 8B2.1 (2009), (stating that it is not necessary to employ a separate staff or organization to carry out the compliance function and using existing personnel is acceptable for small organizations); Tabuena & Smith, *supra* note 85, at 14 (contending that corporations often designate the GC to take on this role and that the new guidelines "recognize that the small and mid-size organization often do not have the resources to create an entirely new officer-level position to manage the program . . . . by offering an endorsement for utilizing existing officers rather than creating a new CCO position.").

182. *See* Robert L. Nelson & Laura Beth Nielsen, *Cops, Counsel, and Entrepreneurs: Constructing the Role of Inside Counsel in Large Corporations*, 34 LAW & SOC'Y REV. 457, 470 (2000) ("The ability to "trump" a business decision has been identified by researchers as a source of contention and confusion for both lawyers and their business clients from the earliest studies of Donnell (1970) and Rosen (1984). Cops and counsel continue to confront such tensions."). Sung Hui Kim, *supra* note 18, at 76 (coining the debates over the SEC's efforts to require lawyers to gatekeep as "gatekeeping wars"); Pam Jenoff, *Going Native: Incentive, Identity, and the Inherent Ethical Problem of In-House Counsel*, 114 W. VA. L. REV. 725, 731–32 (2012) (describing the gatekeeping functions of in-house counsel).

183. There is an ongoing debate about whether internal or external lawyers are better situated to play a gate-keeping role. *See generally* Sung Hui Kim, *Gatekeepers Inside Out*, 21 GEO. J. LEGAL ETHICS 411, 429 (2007); Robert A. Kagan & Robert E. Rosen, *On the Social Significance of Large Law Firm Practice*, 37 STAN. L. REV. 399, 435 (1985). After what Robert E. Rosen aptly calls the "inside counsel movement" (much of which is often attributed to Ben

should be "officers of the court" and play a gatekeeping role goes back to the 1800s,[184] and is a common theme in the literature and the history of the legal profession.[185] Historically, the legal profession

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Heineman), the role of the lawyer became bifurcated. Rosen, *Inside Counsel Movement*, *supra* note 8, at 483–84. In-house lawyers argued that they were "better able to play the gatekeeping roles than outside lawyers because they were part of the client and therefore were better able to assess risk and counsel against risky behavior." Wilkins, *Rivals*, *supra* note 49, at 2083–84 ("General counsel were therefore the lawyers who should be entrusted with the role of being both a "partner" to the business in achieving its objectives and the "guardian" of the company's long-term reputation and values."); Ben W. Heineman, Jr., *Caught in the Middle*, CORP. COUN., (2007), *avaialble at* http://www.law.harvard.edu/programs/corp-gov/articles/Heinemann-CC-Caught-in-the-Middle-April 07.pdf (arguing that general counsel must be both "partners" and "guardians"); *see* Deborah A. DeMott, *The Discrete Roles of General Counsel*, 74 FORDHAM L. REV. 955, 960–61 (2005) (explaining that even those that did not believe that outside lawyers could play the role of gatekeeper, believed that in-house lawyers could). The counter argument, of course, is that as in-house lawyers become a part of the client they are more likely to serve in the role as advocate for their client as opposed to engage in counseling for the public interest. Robert E. Rosen, *We're All Consultants Now: How Change in Client Organizational Strategies Influences Change in the Organization of Corporate Legal Services*, 44 ARIZ. L. REV. 637, 671–72 (2002); *see generally* Nelson & Nielsen, *supra* note 181(empirical research that demonstrates this problem); *see* Coffee, *supra* note 18, at 195 (warning that even if "inside counsel [are] uniquely positioned to specialize in preventive law," there are many reasons to doubt that they can or will). Two empirical studies conclude that in-house lawyers are not well suited to play this gatekeeping role because they defer to management decision-making. Robert E. Rosen, Lawyers and Corporate Decision-Making (1984) (unpublished Ph.D. dissertation, University of California at Berkeley) (on file with author); Nelson & Nelson, *supra* note 181, at 470-73 (concluding that inside counsel are "subservient to managerial prerogatives . . . [and] typically leave the final call on acceptable levels of legal risk to the businessperson involved"). Other scholars have concluded the opposite. *See, e.g.*, Rostain, *supra* note 19 (finding that the lawyers in her study claimed "responsibility for determining the appropriate level of risk to be undertaken by their companies lay with them"); *see also* the Compliance Study, *supra* note 26 and accompanying text. With respect to outside lawyers, scholars have often argued that the reason why outside lawyers were not able to continue to play the "lawyer statesman" role is because they do not have a close partnership with the client—like that of in-house counsel after the movement. Wilkins, *Rivals*, *supra* note 49, at 2076; *see, e.g.*, Coffee, *supra* note 18, at 194–95 (noting that the relationship between law firms and their corporate clients is now "less intimate, ongoing or fully informed than is the relationship between the same corporation and its outside auditor"). *See* ANTHONY T. KRONMAN, THE LOST LAWYER: FAILING IDEALS OF THE LEGAL PROFESSION 15 (1993). *Cf.* Kagan & Rosen, *supra* note 183, at 423–35 (1985) (asserting that the law firm "lawyer-as-influential-and-independent-counselor role is likely to be extraordinary rather than ordinary" and that outside corporate attorneys do not "aspir[e] to serve as molders of corporate and public policy.").

184. Wilkins, *Rivals*, *supra* note 49, at 2073 ("[T]he idea that lawyers should be 'officers of the court' with responsibilities to the public purposes of the law, however, is as old as the profession itself."). *See generally* Eugene R. Gaetke, *Lawyers as Officers of the Court*, 42 VAND. L. REV. 39 (1989). Reinier Kraakman has been credited as being the first to use the term "gatekeeper" to describe the lawyer's role and analyze whether lawyers can fulfill this role. *See* Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53 (1986).

185. *Cf.* Ben W. Heineman, *The Ideal of the Lawyer-Statesman*, 22 ACCA DOCKET 59, 60–62 (2004) (quoting Gordon); *see also* Z. Jill Barclift, *Preventative Law: A Strategy for Internal Corporate Lawyers to Advise Managers of their Ethical Obligations*, 33 J. LEGAL PROF. 31, 45 (2008) ("In the wake of criticism of corporate management misconduct and the role of lawyers

views gatekeeping as consistent with lawyers' professional obligations. David B. Wilkins, in his recent article on the nature of the relationship between law firms and corporate clients, argues that lawyers have historically (since Cravath first opened its doors at the end of the nineteenth century) "aspired to be wise counselors, or 'lawyer-statesmen' . . . who played a key role in shaping their clients' goals and in mediating between these private ends and the public purposes of the legal framework."[186]

Along the same lines, in 2003, the ABA Task Force on Corporate Responsibility (stemming from the fall of Enron) (and in response to the passing of Sarbanes-Oxley Section 307) recommended that the general counsel be the primary official in charge of the compliance function (with direct oversight by the board).[187] The ABA which had consistently resisted imposing gate-keeping and whistle-blowing duties on lawyers[188] amended the Model

as enablers of corporate misconduct, internal corporate lawyers increasingly describe their responsibilities to include counsel on moral advice."); Parker, *Ethics of Advising*, *supra* note 1, at 343–44. *Id.* at 344 (explaining that "prevention-oriented legal practice is not a top-down model of a legal adviser mediating the law to companies (independent counselor), nor a client-dominance model in which the legal adviser creates law to suit corporate purposes (adversarial advocate). It is a model of dialogue, of accommodation and of day to day, hour to hour involvement in the politics, business and management of the "client" organization [sic] that employs the compliance professional.") Granted, positions taken by professional organizations, scholars, and lawyers are relevant, but they are not necessarily persuasive. However, the purpose of this section is to demonstrate that there are guidelines, rules, and regulations that support lawyers role as gatekeepers and able to report misconduct despite their role as advocate. For further discussion of the role of corporate attorney as gatekeeper, *see infra* Part IV.B.2.

186. Wilkins, *Rivals*, *supra* note 49, at 2073–75; *id.* at 2075 ("By the so-called "Golden Age" of the large law firm in the middle decades of the twentieth century, this "Whiggish ideology" had become the accepted understanding of the corporate lawyer's role."); *see* Russell G. Pearce, *The Legal Profession As a Blue State: Reflections on Public Philosophy, Jurisprudence, and Legal Ethics*, 75 FORDHAM L. REV. 1339, 1347–58 (2006) (contending that until the middle of the nineteenth century, it was taken for granted that lawyers owed the public special duties and their higher duty was the public good); Norman W. Spaulding, *The Discourse of Law in Time of War: Politics and Professionalism During the Civil War and Reconstruction*, 46 W.M. & MARY L. REV. 2001, 2029–39 (2005); *see also* ABA CANONS OF PROFESSIONAL ETHICS pmbl. (1908); MODEL RULES OF PROFESSIONAL CONDUCT pmbl. (2011). For a review of the history behind a relational understanding of lawyer's role and ethics and when a shift occurred, *see* Russell G. Pearce & Eli Wald, *Rethinking Lawyer Regulation: How a Relational Approach Would Improve Professional Rules and Roles*, MICH. ST. L. REV. 513, 513–23 (2012).

187. James H. Cheek, III, et al., REPORT OF THE AMERICAN BAR ASSOC., TASK FORCE ON CORP. RESP. 2003 32; AMERICAN BAR ASSOCIATION ADOPTED BY THE HOUSE OF DELEGATES (2003), *available at* http://www.abanet.org/leadership/2003/journal/119a.pdf (amending rule 1.6 and 1.13); William H. Volz and Vahe Tazian, *The Role of Attorneys Under Sarbanes-Oxley: The Qualified Legal Compliance Committee as Facilitator of Corporate Integrity*, 43 AM. BUS. L. J. 438 (2006); Tabuena, *supra* note 56, at n.8.

188. Further, the ABA in particular has before resisted efforts to view the attorney's role as more than an advocate zealously defending the corporate client. *See* Coffee, *supra* note 18, at 192. For example, in 1981, the ABA argued against the adoption of SEC proposed regulations

Rules regarding confidentiality and Model Rule 1.13 (the rule governing lawyers who represent corporations and other organizations) to enable in-house lawyers to play a gatekeeping role. First, under Model Rule of Professional Conduct 1.6, lawyers *can*, when reasonably necessary, disclose information to external parties to prevent a client from "committing a crime that is reasonably certain to result in substantial injury to the financial interests or property of another" or to "prevent, mitigate or rectify" financial injury "that is reasonably certain to result or has resulted from the client's commission of a crime or fraud."[189] Second, the amendments to Model Rule 1.13, *require* lawyers in certain situations to report to a higher authority within the organization, like the board of directors, any "violation" by a corporate manager that reasonably might be imputed to the organization."[190] If the higher authority refuses or fails to appropriately and timely address conduct that the lawyer believes is "clearly a violation of law" and is "reasonably certain to result in substantial injury to the organization," the lawyer is allowed to disclose information to external authorities that the lawyer "reasonably believes necessary to prevent substantial injury" to the

that would require reporting of corporate noncompliance by corporate counsel. *See* Stephanie R.E. Patterson, *Section 307 of the Sarbanes-Oxley Act: Eroding the Legal Profession's System of Self-Governance?*, 7 N.C. BANKING INST. 155, 158–59 (2003) (citing THOMAS LEE HAZEN & DAVID L. RATNER, SECURITIES REGULATIONS 392–93 (6th ed. 2003)). Moreover, the ABA's Ethics 2000 Commission originally refused to revise the section detailing remedies available to attorneys that learn of corporate misconduct that is injurious to the corporation despite the SEC's prior attempts. Richard W. Painter, *The Evolving Legal and Ethical Role of the Corporate Attorney After the Sarbanes-Oxley Act of 2002: Panel 2: The Evolution of Corporate Governance*, 52 AM. U. L. REV. 613, 617–18 (2003). It also originally refused to amend Model Rule 1.6 to allow attorneys to disclose illegal conduct that could prevent a future crime. *The Evolving Role of the Corporate Attorney After the Sarbanes-Oxley Act of 2002*, 52 AM. U. L. REV. 613, 617–18 (2003); *see also* Jeffrey I. Snyder, *Regulation of Lawyer Conduct Under Sarbanes-Oxley: Minimizing Law-Firm Liability by Encouraging Adoption of Qualified Legal Compliance Committees*, 24 REV. LITIG. 223, 228 (2005) (stating that the SEC probably would not have intervened if the ABA Ethic's 2000 Commission had required attorneys to report illegal conduct to the corporation's board of directors).

189. MODEL RULES OF PROF'L CONDUCT R 1.6 (2012) (this rule does not cover the situation wherein clients use lawyers' services to further criminal or fraudulent conduct without lawyers' knowledge).

190. *Id.* at R. 1.13(b) (requiring lawyers to report to a higher authority—like the board—when the lawyer "knows" that an employee is engaged in or intends to act in a way that violates the law and that this violation may be attributed to the organization and is likely to result in substantial injury to the organization, and the lawyer reasonably believes it is in the best interest of the organization to report). Model Rule 1.13 used to allow lawyers to consider a broad range of actions if the lawyer thought someone was doing something wrong that might harm the corporation (through liability or regulatory action). *See Id.* (allowing the lawyer to "refer the matter to higher authority in the organization, including, if warranted by the circumstances to the highest authority that can act on behalf of the organization as determined by applicable law," if the lawyer believes it is in the best interest of the organization).

organizational client.[191] Further, the rule protects lawyers that believe that they have been forced to withdraw or have been discharged for reporting to higher authority within the organization.[192] Although this rule provides lawyers with a great deal of discretion, the point is that the recent governmental settlement mandates that presume that lawyers do not have the requisite independence to report wrongdoing is incongruent with the historical view taken by the legal profession and some of the recent revisions to the Model Rules of Professional Conduct for lawyers.

3. Sarbanes-Oxley

In 2002, in recognition that lawyers (directly or indirectly) facilitated corporate misconduct by failing to protect the corporation, Congress enacted section 307 of the Sarbanes-Oxley Act of 2002.[193]

191. *Id.* at R. 1.13(c). This rule allows more reporting than Model Rule 1.6 because it allows disclosure only when the lawyer's services were used in furtherance of the misconduct. Further, R. 1.6 requires that there be a financial crime or fraud whereas R. 1.13 only requires a violation of civil law or legal obligation to the corporate client. Lastly, R. 1.6 is discretionary whereas R. 1.13 is mandatory. In some states, R. 1.6 is interpreted to be mandatory, not discretionary. According to the FLORIDA RULES OF PROF'L CONDUCT R. 4-1.6 (2013), which is close to the equivalent to MODEL RULES OF PROF'L CONDUCT R. 1.6 (2013), lawyers are "impliedly authorized" to disclose. R. 4-1.6(b)(1) states that a lawyer must reveal information to prevent the client from committing a crime. Other scholars have argued, however, that this rule has very little teeth and that it actually requires the lawyer NOT to go up the ladder unless the fraud is likely to result in substantial injury to the corporation. *See, e.g.,* MONROE H. FREEDMAN & ABBE SMITH, UNDERSTANDING LAWYERS' ETHICS 104, 149–50 (3d ed. 2004) (explaining that in Rule 1.13 "the lawyer is expressly directed to act 'in the best interest of the organization'").

192. MODEL RULES OF PROF'L CONDUCT R. 1.13(c) (2013). As Wilkins points out, these provisions "protect the public from corporate misconduct, impose on the lawyer gatekeeping responsibilities, and provide in-house lawyers at least some leverage against retaliation by those who might be tempted to ignore the lawyer's advice or punish him or her for trying to give it." Wilkins, *Rivals, supra* note 49, at 2127–28 (pointing out that these reforms do not "alter a corporate client's fundamental right to exclude lawyers from the venues where important decisions are made or to strategically manipulate the information the lawyer receives").

193. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 307, 116 Stat. 745, 784 (2002) (codified as amended at 15 U.S.C. § 7245 (Supp. II 2002)). Mike Allen, *BUSH SIGNS CORPORATE REFORMS INTO LAW; PRESIDENT SAYS ERA OF 'FALSE PROFITS' IS OVER*, WASH. POST, July 31, 2002, at A4 (reporting that the Act was approved by the U.S. House of Representative by a vote of 423 to 3 and in the U.S. Senate by a vote of 99 to 0). *See* Sung Hui Kim, *The Banality of Fraud: Re-situating the Inside Counsel as Gatekeeper*, 74 FORDHAM L. REV. 983, 986 (2005) (explaining that the SEC was "convinced" that "inside counsel are in a superior position to interdict corporate fraud"). Section 307 mandates that the SEC issues rules prescribing minimum standards of professional conduct for attorneys appearing and practicing before the commission. 15 U.S.C. § 7245 (2006). *See* Peter C. Kostant, *From Lapdog to Watchdog: Sarbanes-Oxley Section 307 and a New Role for Corporate Lawyers*, 52 N.Y.L. SCH. L. REV. 535, 544–45 (2007/2008) (explaining that reporting misconduct is now mandatory and that the standard for reporting is the credible evidence standard which is less difficult to achieve than the prior knowledge standard. Misconduct can be in the past or unrelated to legal representation, and the SEC actually enforces section 307, whereas Model Rule 1.13 was hardly

Under the act, the chief legal officer of the company is one of the two primary executives given responsibility for handling the reporting of "evidence of material violation."[194] Section 307 mandates that the standards of professional conduct for attorneys appearing and practicing before the commission include a rule requiring attorneys to report evidence of material violations of securities laws or breaches of fiduciary duty or similar violations by the issuer up the ladder within the company and then outside the company to the audit committee or board of directors.[195] The SEC passed Rule 205.3(b) in response, which entails a reporting up scheme that starts with internal reporting up to higher ranking officials and the board of directors and then proceeds externally.[196] The lawyer, who learns of a possible material

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ever enforced).

194. 17 C.F.R. § 205.5(i) (2006) (defining "material violation"). Other responsibilities for both inside and outside attorneys were specified; SEC Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. § 205.4 (2003) (supervisory attorneys responsibilities); 17 C.F.R. § 205.5 (2003) (subordinate attorney responsibilities).

195. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 307, 116 Stat. 745, 784 (2002) (the rule enacted by the SEC is 17 C.F.R. § 205, 68 Fed. Reg. 6296); *see* Kostant, *supra* note 193, at 545 (stating that the SEC adopted § 205, which "requires lawyers to report up evidence of material illegality or breach of fiduciary duties to the board or a qualified legal compliance committee unless the attorney believes that the CLO or CEO has provided an appropriate response."). There is no obligation to report evidence of material violation if an attorney was retained to investigate such evidence of a material violation and is reporting it to the CLO, and the CLO is reporting to the board (unless the attorney and CLO reasonably believe there is no material violation). Maria Castilla, *Client Confidentiality and the External Regulation of the Legal Profession: Reporting Requirements in the United States and United Kingdom*, 10 CARDOZO PUB. L. POL'Y & ETHICS J. 321, 332–36 (2012); *see also* David A. Delman & Paul A. Bruno, *Up the Ladder and Out the Door: Saying "No" to the CEO*, 46 INT'L LAW. 1007, 1017–22 (2012).

196. 17 C.F.R. § 205.2(e) (2004). Although they may not place a duty on attorneys to report up or out or counsel clients to different behavior, other SEC rules exist that place obligations on attorneys to refrain from helping their clients in noncompliance. For example, lawyers aid their corporate clients in drafting and preparing many types of public disclosure documents, including filings for the SEC, and documents on securities offerings.

10(b) of the 1934 Securities and Exchange Act, and Rule 10b-5 of the Securities and Exchange Commission apply to attorneys. 15 U.S.C. § 78j (2009). 200. 17 C.F.R. § 240.10b-5 (2010), 15 U.S.C. 78j(b) (2009) (prohibiting publicized deceit, misrepresentations, or omissions that materially affect the purchase or sale of securities). There is no private right of action against secondary actors under 10(b), however, the provisions prevent attorneys from directly or substantially participating in misrepresentations or manipulative and deceptive conduct in connection with a sale or purchase of a security. *See* Stoneridge Inv. Partners, Inc v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008); Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 194 (1994); Elizabeth A. Nowicki, *10(b) or Not 10(b)?: Yanking the Security Blanket for Attorneys in Securities Litigation*, 2004 COLUM. BUS. L. REV. 637, 639 ("[Central Bank] was a windfall for attorneys and other non-issuer defendants such as accountants, analysts, and underwriters who had historically been brought into Section 10(b) lawsuits as aiders and abettors. [And its] implications were huge: the attorney conspirators who were critical to effectuating fraudulent transactions now appeared to be almost unreachable by defrauded investors."). Despite the decision in *Stoneridge*, some courts have applied 10-b5 liability to lawyers (and other secondary actors) as primary violators of securities laws under alternative

violation, must report the evidence to the chief legal Officer ("CLO") (and may also report it to the CEO).[197] The CLO is then required to conduct an appropriate inquiry into the reported violation and to advise the reporting attorney of his/her determination and the response that will be or has been taken.[198] If these officials do not respond appropriately, Part 205 requires reporting to the audit committee or the board of directors.[199] This rule places more gatekeeping responsibility on the lawyer than does the bar. Model Rule 1.13(b) requires lawyers to go up the ladder only when the lawyer "knows" of a violation or legal duty "reasonably likely" to result in substantial corporate injury. The new SEC rule, however, is triggered by "credible evidence, based upon which it would be unreasonable for a prudent and competent attorney not to conclude

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theories like the "substantial participation" standard and the "creator" standard. *See, e.g.*, *In re* Enron Corp., 235 F. Supp. 2d 549, 583–90 (S.D. Tex. 2002) (describing three different standards "to determine when the conduct of a secondary actor makes it a primary violator" and applying the "creator standard" proposed by the SEC proposed standard); Elizabeth Cosenza, *Rethinking Attorney Liability under Rule 10B-5 in Light of the Supreme Court's Decisions in Tellabs and Stoneridge*, 16 GEO. MASON L. REV. 1, 47–48 (2008) (arguing for a liability standard under Rule 10b-5(b) that "promotes the securities laws' goals of accurate and continuous disclosure and enforces" a gatekeeping role for secondary actors); *id.* at 18–26 (reviewing the different standards). Further, the SEC can bring suits against lawyers for aiding and abetting securities fraud. *See* Stoneridge Inv. Partners, Inc., 552 U.S. 163; Sung Hui Kim, *Gatekeepers Inside Out*, 21 GEO. J. LEGAL ETHICS 411, 429 n.90 (2007) (The "PSLRA clarified that the SEC (but not private parties) may bring enforcement actions and administrative proceedings against aiders and abettors of securities fraud, so long as the SEC could prove that such persons 'knowingly' did so.").

197. 17 C.F.R. §205.3 (b)(1)(2006). Rule 205 allows the lawyer or the CLO to report the evidence to the Qualified Legal Compliance Committee ("QLCC") if the company has created one; and then the lawyer is relieved of all future duties to report up the ladder. 17 C.F.R. §205.3 (c)(1)(2006) If the lawyer had reported the violations to the CLO, the CLO can report the evidence to the QLCC and then is relieved of all future investigative responsibilities unless appointed to handle the investigation. 17 C.F.R. §205.3 (c)(1)(2006). For a description of QLCCs and recommendations to corporations about adopting QLCCs see Volz & Tazian, *supra* note 187; *see also* Jill E. Fisch & Caroline M. Gentile, *The Qualified Legal Compliance Committee: Using the Attorney Conduct Rules to Restructure the Board of Directors*, 53 DUKE L.J. 517, 524–27 (2003).

198. 17 C.F.R. §205.3 (b)(2)(2006).

199. Contrary to the initial proposal, there is no requirement that the attorney report the transgression to the SEC if the company fails to comply. G. Thomas Stromberg, Jr. & Anna R. Popov, *Lawyer Conduct Rules Under Sarbanes-Oxley & State Bars: Conflicts to Navigate?* 4 (Wash. Legal Found., Critical Legal Issues, Working Paper No. 132, July 2005) [hereinafter Stromberg, et al., *Lawyer Conduct Rules*]; Lawrence A. West, *Can Attorneys Be Award-Seeking SEC Whistleblowers?*, THE HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (June 17, 2013, 9:22 AM), http://blogs.law.harvard.edu/corpgov/2013/06/17/can-attorneys-be-award-seeking-sec-whistleblowers/. However, SEC rule 205 responds to this directive and the SEC is still considering a noisy withdrawal provision similar to that originally proposed. Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Res. 6292-01 (Feb. 6, 2003); Stromberg, *Lawyer Conduct Rules*, at 2–5.

that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur."[200]

According to commentators, the Sarbanes-Oxley Act of 2002 has attempted to "deputize a public corporation's CLO as a gatekeeper of our national securities markets."[201] Research by other scholars, like Tanina Rostain and David B. Wilkins, support that these Sarbanes-Oxley changes have enabled general counsel—especially in the name of "compliance—to stand up against corporate misconduct, instill a culture of compliance, and play a gatekeeping role."[202]

Further, in 2004 the SEC adopted a new rule under the Investment Company Act of 1940 and Investment Advisers act of 1940,[203] dubbed the "Compliance Rule"[204] that requires each investment company and investment adviser registered with the SEC to adopt and implement written policies and procedures to prevent violation of the federal securities laws, and to designate a chief compliance officer to be responsible and to report directly to the fund board and meet with independent directors at least once a year.[205]

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200. 17 C.F.R. §205.2(e); *see* Castilla, *Client Confidentiality*, *supra* note 195, at 332–44.

201. Kim, *supra* note 193, at 986 (contending, however, that inside counsel have failed to adequately fill this gatekeeping role and criticizing SEC regulations and the *Model Rules of Professional Conduct* for "set[ting] [general counsels] up for failure"); *see also* Cosenza, *supra* note 196, at 47-48 (arguing for a standard of liability under Rule 10b-5(b) that "promotes the securities laws' goals of accurate and continuous disclosure and enforces" lawyers' gatekeeping role). Indeed, the SEC has proposed an even more onerous standard on attorneys in the past. *In re* William R. Carter & Charles J. Johnson, Jr., Exchange Act Release No. 17,597, 47 SEC Docket 471, 511 (Feb. 28, 1981) ("When a lawyer with significant responsibilities in the effectuation of a company's compliance with the disclosure requirements of the federal securities laws becomes aware that his client is engaged in a substantial and continuing failure to satisfy those disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client's noncompliance.").

202. Rostain, *supra* note 19, at 473 and 488–89 (providing caveats about the small sample size); Wilkins, *Rivals*, *supra* note 49, at 2130 ("Surveys of the attitudes of general counsel after the passage of the Act appear to support this conclusion, as does the fact that many companies increased their spending on outside counsel during this period."); *cf.* William H. Simon, *The Kaye Scholer Affair: The Lawyer's Duty of Candor and the Bar's Temptations of Evasion and Apology*, 23 LAW & SOC. INQUIRY 243, 253–58 (1998), *reprinted, in* PROBLEMS IN PROFESSIONAL RESPONSIBILITY FOR A CHANGING PROFESSION 262, 269–72 (Andrew L. Kaufman & David B. Wilkins eds., 5th ed. 2009) (arguing that there are three possible levels of duty for reporting from the maximum which requires affirmative disclosures, intermediate which prohibits directly or indirectly misleading conduct, to minimum, which prohibits only explicit misrepresentation and direct assistance of it).

203. Compliance Programs of Investment Companies and Investment Advisers, 68 Fed. Res. 74,714 (Dec. 24, 2003).

204. *Id.*; Richards, *New Compliance Rule*, *supra* note 17.

205. SEC Final Rule: Compliance Programs of Investment Companies and Investment Advisers, 17 C.F.R 270 & 275 (2004); SEC Investment Advisor Code of Ethics, 17 C.F.R 270, 275, & 279 (2011) (mandating that registered advisers also adopt codes of ethics). *See also* H. Res. 3763, 107th Cong. (2002) (enacted). SEC Final Rule: Compliance Programs of Investment Companies and Investment Advisers, 17 C.F.R 270 & 275 (2004). According to reports by others, before congress passed this law, most of the 9000 publicly held U.S. corporations did not

The SEC has stated that the chief compliance officer should have a "position of sufficient seniority and authority within the organization to compel others to adhere to the compliance policies and procedures."[206] Although this rule appears consistent with the governmental mandates described in the prior part of this Article, the rule does not require advisers to hire an additional executive to serve as the compliance officer, but rather to designate an individual as the adviser's chief compliance officer.[207] Moreover, the rule does not prohibit the chief compliance officer from also reporting to the general counsel of the corporation.[208]

In sum, recent rules, guidelines, and recommendations by both governmental and non-governmental entities arguably justify buttressing corporate compliance initiatives and designating one person as a chief compliance officer that has direct access to the board. However, they do not directly support—and are sometimes in tension with—the recent mandates by the government to departmentalize compliance and entirely remove the general counsel from compliance oversight responsibilities.

IV. ANALYSIS: SHOULD CORPORATIONS PREEMPTIVELY DEVELOP COMPLIANCE DEPARTMENTS THAT ARE SEPARATE AND INDEPENDENT FROM THE LEGAL DEPARTMENT?

As discussed above, there is an increased emphasis on corporate compliance initiatives and a trend to separate out the compliance function from legal department oversight and create new compliance

have chief compliance officers. *See* Hurt III, *supra* note 132 ("Sarbanes-Oxley has made chief compliance officers almost as important to corporate success—or at least survival—as chief executives and chief financial officers."). The Sarbanes-Oxley Act also requires a qualified legal compliance QLCC in certain situations. *Cf.* Fisch & Gentile, *supra* note 197, at 583–84 (suggesting that the SEC highlighted the benefits of QLCCs without describing the numerous, associated costs and concluding that for QLCCs to be successful, there should be incentives for active director monitoring).

206. SEC Final Rule: Compliance Programs of Investment Companies and Investment Advisers, 17 C.F.R 270 and 275 (2004).

207. Richards, *New Compliance Rule*, *supra* note 17, at 5. ("I would not automatically assume that it should be placed within Legal or report through the General Counsel (remember that the Chief Compliance Officer also reports directly to the fund's board of directors). Intertwining the corporate legal duties and the duties of the compliance officer may create conflicts not only in the implementation of the compliance program but also in the examination of the program. If you decide that the Chief Compliance Officer will report to Legal, counsel will have to clearly articulate instances of client privilege and show great effort to segregate any dual responsibilities.").

208. For a detailed description of the requirements of Rule 38a-1 under the Investments Company Act of 1940 and Rule 206(4)-7 under the Investment Advisers Act of 1940, see Rule 38a-1 Legal Alert, *supra* note 36.

departments that are largely comprised of non-lawyers and non-practicing lawyers, led by a chief compliance officer who reports directly to the CEO and/or the board.[209] The question is: Is this best practice? Or is the recent stance by the government a formal solution that, at the end of the day, does not create the type of change that is needed to ensure substantive and sustained change to corporate culture? As one general counsel interviewee pointed out:

> a number of the early mover companies that created compliance departments did so as part of resolving major mishaps or high profile problem—so it was not necessarily a best practice. But after a number of major companies have done it over the years, it starts to look like a best practice. Once in that position, it becomes hard for a major corporation to explain why they don't need a compliance department.[210]

The legislature, judiciary, and private regulatory bodies have all emphasized the importance of developing effective compliance and risk management structures.[211] And there is an increased interest in understanding how companies develop internal controls and compliance systems to respond to the threat of external regulatory enforcement.[212] However, there is much debate over who should have jurisdiction over compliance departments within organizations[213] and there are a range of stakeholders such as the government, public, corporation, and legal profession.[214] This Part, therefore, begins by summarizing the common arguments for and against

209. Hannah D' Apice, *Is the SEC's Recent Run of High-Profile Prosecutions a Flash in the Pan?*, CORPORATE COUNSEL, July 21, 2011. ("Most corporations are responsible, and the level of internal compliance and compliance programs for responsible corporations is radically different from what you saw 15 years ago. . . . There will continue to be resources devoted to compliance programs—more monitoring, more self-investigation. . . . They want to make sure that they avoid getting swept up in these potentially large cases that could be financially devastating to any corporation. Everyone gets it; I think it is a rare company that doesn't.") (quoting Richard Scheff chairman of Montgomery, McCracken, Walker, & Rhoads, and former consultant to the Assistant Secretary of the Treasury for Law Enforcement); Boehme, *supra* note 174 (claiming that a large percentage of CCOs are lawyers but there are also some successful nonlawyer CCOs); *see also* Langevoort, *supra* note 19, at 6 (describing new trend to have a CECO that is separate and independent from the CLO and that some argue that the CECO should not be a lawyer).

210. Interviewee Stage 2 FGC2. *See also supra* note 52.

211. Rosen et al., *Lawyers are Followers and the Poetry of Resilience* (2012) (draft on file with Author) at 18.

212. *See generally* Parker, OPEN CORPORATION *supra* note 25; *See generally* CHRISTINE PARKER & LAUREN NIELSEN, EXPLAINING COMPLIANCE: BUSINESS RESPONSES TO REGULATION (2011); Parker & Gilad, *supra* note 17; Parker & Nielsen, *Corporate Compliance Systems: Could they make a difference?*, 41 ADMINISTRATION & SOC'Y 3–37 (2009).

213. Langevoort, *supra* note 19, at 6.

214. *See generally supra* notes 35–39 and accompanying text discussing the other stakeholders involved in this debate and potential perspectives the analysis could consider.

departmentalization and dividing them into three types. Utilizing this categorization, the strength of the arguments for departmentalization are analyzed from the public's perspective,[215] considering the presumptions that departmentalization will increase access to information about noncompliance, actual compliance, and a corporation's commitment to compliance and ethics. This analysis explores the effects of removing the legal department from the role of compliance gatekeeper, and identifies potential negative consequences that have yet to be considered seriously in the literature and that may tip the balance against departmentalization.

A. COMMON ARGUMENTS FOR AND AGAINST DEPARTMENTALIZATION: A PROPOSED TYPOLOGY

Proponents of departmentalization argue that there is an inherent conflict of interest between the general counsel's main objective to protect the corporation and encouraging reports of noncompliance.[216] Separating compliance from legal, the proponents contend, will increase reports of noncompliance to both the board of directors and the government because the chief compliance officer will be independent and autonomous.[217] Second, the government and public will have more access to information when a corporation is investigated because information will flow directly from the chief compliance officer and the attorney-client privilege is less likely to apply to communications with a chief compliance officer that is not acting at the direction of the general counsel.[218] Third, more ethical and legal transgressions will be prevented because the compliance officer's role is to counsel on ethical and social responsibility whereas the general counsel's role is to provide advice related to the technical requirements of the law.[219] Further, there is something about the role

215. *Id.*

216. *See, e.g.*, SCCE Study March 2013, *supra* note 10, at 4–5; *see Tabuena & Smith, supra* note 85, at 14–15.

217. Boehme, *supra* note 174 (emphasizing the importance of autonomy from management and using Wal-Mart's recent misconduct as an example where the general counsel is alleged to have recommended that the CEO hire outside counsel that had approved the brides); Langevoort, *supra* note 19, at 5 (explaining the argument for independence and autonomy).

218. *See generally* Tabuena & Smith, *supra* note 85, at 13–15. *See, e.g.*, SCCE Study March 2013, *supra* note 10, at 4–5 ("Compliance should be independent of Legal to ensure that information flow is not interrupted or spun.") (quoting a compliance officer). *See infra* notes 296–298 and accompanying text.

219. As discussed, common statement by chief compliance officers is that the general counsel merely tells whether you can do something as opposed to whether you "should" do something. However, this is not the view taken by many general counsels, scholars, and the ABA. *See generally infra* notes 335–341 and accompanying text.

of a lawyer that interferes with the ability to create a corporate culture of ethics and compliance.[220]

Opponents argue that turf wars will develop between newfound chief compliance officers and general counsels that will impede the reporting of noncompliance and will create inefficiencies due to overlap in function.[221] Second, these opponents argue, general counsel actually do have sufficient autonomy and independence to serve in the gatekeeping role and have already demonstrated that they can manage conflicts of interest that exist between compliance reporting obligations and protecting the corporation.[222] Lastly, they contend that general counsels should continue to play a gatekeeping role and that they are better able to do so given their position in the company.[223]

All of these arguments can be categorized into three types: 1) autonomy and independence; 2) transparency; and, 3) role. It is to this typology that the next section turns.

B. AUTONOMY AND INDEPENDENCE

One rationale for departmentalization is that it will establish a high-level executive with the requisite autonomy and independence to uncover, report, and prevent noncompliance.[224] The belief is that when legal and compliance are housed together, there is an inherent conflict of interest between the chief compliance officer's duty to

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220. Langevoort, *supra* note 19, at 5, 6 ("There is a strong strand in the organizational behavior literature (admittedly, a field dominated by nonlawyer academics) that something in the training, socialization, and professional identity of the lawyer interferes with the ability to generate an ethical corporate culture."); *see* Linda Klebe Treviño et al., *Managing Ethics and Legal Compliance: What Works and What Hurts*, 41 CAL. MGT. REV. 131, 146 (1999) ("[Lawyers'] education and background best prepare them to develop a legal compliance approach, not a values approach."); *see generally infra* note 323 and accompanying text. This part provides an overview of the common arguments for departmentalization. For a less common argument, see *supra* note 125.

221. Boehme, *supra* note 174 (contending arguments of turf wars are the least concern); Langevoort, *supra* note 19, at 5 (discussing the "strong scent of professional competition" between lawyers and compliance officers).

222. *See, e.g.*, Heineman, *supra* note 183; Langevoort, *supra* note 19, at 6 (explaining that the "literature often claims that the lawyering-compliance role situates the CLO and staff as a guardian of corporate integrity, the "conscience of the corporation" or some variant thereof, so that the legal role takes on ethical responsibilities as well"); Heineman, *supra* note 46, at 7, 14–15.

223. *See, e.g.*, Ben W. Heineman, Jr., *The General Counsel as Lawyer-Statesman*, *supra* note 46, at 14. http://www.law.harvard.edu/programs/plp/pdf/General_Counsel_as_Lawyer-Statesman.pdf; *see also* Rostain, *supra* note 19, at 485 (reporting that general counsels feel that their position as secretary to the board of directors provides a level of power and influence).

224. Also, this focus on the chain of command is in keeping with the focus of corporate law, which according to Robert E. Rosen, "is concerned with Generals and leaves it to Generals to command the troops." Rosen, *supra* note 20, at 1160.

report and the general counsel's obligations to hold confidences confidential and defend the corporation.[225] Given the rules and standards regulating lawyers, a general counsel does not have the same obligation—or independence—to report transgressions to the board like a chief compliance officer does. Separation creates a position for an executive (that is not serving in a legal capacity) that can, and is required, to uncover and report compliance in a way that will increase compliance and the opportunity for criminal prosecution. Essentially, this is an argument centering on independence—or lack thereof, if the chief compliance officer reports to the general counsel. The argument is that by being independent, the chief compliance officer will have the autonomy to report and stop noncompliance. Although, as described in Part II, there are instances where the general counsel can and is required to report noncompliance, a chief compliance officer has a different objective than the general counsel and therefore, may handle the reporting differently than would the general counsel. If the chief compliance officer uncovers misconduct by an employee, he/she may want to publicize the misconduct and make an example out of the person (in order to deter future misconduct) whereas the general counsel might want a quiet severance pay agreement to get rid of the problem. As one interviewee aptly described:

There would very likely be a time when the general counsel would say, "It's not in our interest to report the wrongdoing to the government," in which the compliance officer could say, "But we need to report to the government to get the credit."[226]

Further, creating a separate department and changing reporting structure may send a message to the company about the importance of compliance.[227] Creating a compliance department might help develop group identification that cements values and norms around

225. *See, e.g.*, Parker, *supra* note 1, at 341–43 ("Traditional understandings of ethics and the role of corporate lawyers do not easily accommodate the notion of a preventative law practitioner."); *id.* at 349 (explaining the alter argument that lawyers may use their power and sway to control clients); Rostain, *supra* note 19, at 482. *See also* SCCE Study March 2013, *supra* note 10, at 4 (reporting that compliance professionals believe there is a conflict of interest between lawyers' role as defender of the corporation and compliance officers' duty to report).

226. Interviewee Stage 2 CCO5 at 18. *See also* SCCE Study March 2013, *supra* note 10, at 5 ("Legal approach is about controlling information and disclosures, while Compliance approach is more open and less political. Legal tends to move more slowly than Compliance. Legal is about controlling the fallout, while Compliance is about fixing the problem. Compliance should be independent of Legal to ensure that information flow is not interrupted or 'spun.'") (quoting compliance professional survey respondent).

227. *See* Chambliss & Wilkins, *Ethical Infrastructure*, *supra* note 227, at 701,704 (discussing view that law firm "structure" is separate from and opposed to "culture" and arguing that the creation of internal compliance structures is culturally significant serving as a "visible signal of the firm's attention to high ethical standards" whether or not true or effective).

ethical behavior[228] and, therefore, may actually help support a culture of compliance.[229]

From the public's perspective then, departmentalization may potentially increase access to information about noncompliance and help the creation of a corporate culture of compliance. However, something that is not stressed in the debate is that, without power and capability, the benefits of autonomy may not be realized. Further, there may be other tradeoffs.

1. Power and Influence

A compliance officer plays both an independent and dependent role, acting in the interest of the public and the corporation.[230] A compliance officer needs a certain level of political and personal power and influence to be able to utilize an understanding of the law, corporations, and individual motivation to play both roles.[231] Separating the compliance department from the legal department—although it may signal that the corporation is committed to compliance[232]—does not necessarily empower the chief compliance officer or compliance department.

First, departmentalization appears to be based on the idea that getting people and corporations to comply is about "power over" as opposed to power from within and empowerment. Indeed, literature from compliance professionals talks about independence as if it is a precursor for respect and clout.[233] But arguably, decision-making and

228. Parker, *supra* note 1, at 348. Chambliss, Nirvana, *supra* note 110, at 141; *cf.* Valerie Braithwaite, *The Australian Government's Affirmative Action Legislation: Achieving Social Change Through Human Resource Management*, LAW & POLICY 15, 327, 327 (1993).

229. *See generally supra* note 58 and accompanying text supporting that formal trappings of compliance may not be sufficient but can support corporate culture creation. *See also* Lauren B. Edelman & Mark C. Suchman, *When the "Haves" Hold Court: Speculations on the Organizational Internalization of Law*, 33 LAW & SOC'Y REV. 941, 981 (1999) ("[E]ven 'merely symbolic' compliance can exert lasting substantive effects as it redirects organizational attention, alters the organization's public identity, and draws new sets of participants into the organization's dominant coalition.").

230. Parker, *Ethics of Advising*, *supra* note 1, at 345–46.

231. Rosen, *Inside Counsel Movement*, *supra* note 8, at 503.

232. *See generally supra* note 229 and accompanying text; *see also* PwC 2013 Survey, *supra* note 112, at 9 ("[H]aving the CCO report to the CEO raises the profile of compliance. . . . This higher profile structure is usually more impactful than having the CCO report to the legal counsel, or further down in the organization and thus one or more steps removed from the C-suite."). Alternatively, keeping compliance within the general counsel's purview could send a strong signal as well. Rostain, *supra* note 19, at 482 (making a similar point).

233. Parker, *supra* note 1, at 347 (making a similar point); John Bradford Braithwaite & J. Murphy, *Clout and Internal Compliance Systems*, CORP. CONDUCT Q., 52–53 (Spring 1993); Gordon, R. & W. Simon, *The Redemption of Professionalism*, *in* LAWYERS' IDEALS/LAWYERS' PRACTICES: TRANSFORMATIONS IN THE AMERICAN LEGAL PROFESSION 230, 253 (Nelson R. et

power in corporations today is inter and intra; not top-down. To be sure, power within a corporation is not limited to who has access to the board (that is only one kind of power) or based on formal reporting lines.[234] As one chief compliance officer interviewee (that was also an associate general counsel) explained,

> even if the chief compliance officer reports to the [board] or CEO, they are going to have the same problem, because chances are the CEO is going to want to listen to the general counsel . . . because they are their trusted legal advisor. Very rarely is the compliance officer reporting to a CEO, because that's what the CEO wants.[235]

Factors like individual influence and power, compensation, relationships between the executives, and corporate history may also play a role.[236] Further, compliance officers lack the breadth of function like that of a general counsel or even a chief financial officer. In other words, simply because chief compliance officers have the 'C' for 'chief' in their title does not necessarily unlock the door into the "C-Suite" or help them attain credibility or broad stature with the board, CEO, or other business leaders.[237] This may be especially true

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al. eds., 1992).

234. Further, according to corporate governance scholars, new and innovative companies have redesigned to "flatten hierarchy" and "management and the board do not review, let alone direct, the substance of most transactions." Rosen, *supra* note 20, at 1160; *see also* Rostain, *supra* note 19, at 473 ("The [general counsel] occupied positions of power within the managerial hierarchy and were expected to play a significant role in monitoring compliance within the organization. Formal reporting lines, however, did not define the parameters of their authority.").

235. Telephone Interview with Interviewee Stage 2 CCO5, General Counsel. Heineman, *supra* note 19, at 3 ("In a bad company, with a poor culture, a distant board and an indifferent CEO (or worse), independent voices—whether from a chief compliance officer or the GC/CFO—will be muffled and discouraged.").

236. In addition to "title," compensation might affect the level of power and influence a compliance officer has. *See* Chambliss, *Nirvana*, *supra* note 110, at 141 ("Of course, specialists' power to promote compliance with formal rules and policy typically will be greater when law firm management invests in and supports the specialist, making clear that management values compliance."). According to a recent survey by the SCCE of chief compliance officers (one third of which worked at publicly traded companies), chief compliance officers do not on average appear to make as much money as general counsels. *Compare 2012 Cross Industry Chief Compliance Officers Salary Survey*, SOCIETY OF CORPORATE COMPLIANCE AND ETHICS, Jan. 2012, at 15, *available at* http://www.corporatecompliance.org/Resources/View/ArticleId/883/2012-Cross-Industry-Chief-Compliance-Officers-Salary-Survey.aspx (reporting that average base salary for chief compliance officers working at publicly traded companies earned $199,405) to *ACC's Chief Legal Officers Survey 2013 Executive Summary*, ASSOCIATION OF CORPORATE COUNSEL, Jan. 2013, at 5, *available at* http://www.acc.com/CLOsurvey (reporting that thirty-eight percent of survey respondents earn an average base salary of $250,000). (Note: This difference could be related to the survey samples).

237. *Cf. The Chief Compliance Officer of the Future: Embracing a Risk Intelligent View*, DELOITTE INSIGHTS (May 11, 2012), http://www.deloitte.com/view/en_US/us/Insights/Browse-by-Content-Type/podcasts/a8f8676d52c47310VgnVCM3000001c56f00aRCRD.htm (quoting

in those companies that have for years subordinated the chief compliance officer to the general counsel.[238] General counsels, now considered part of senior management (often serving as secretary to the board of directors), have a lot of power, influence, and credibility that will not disappear simply by changing the compliance reporting structure.[239]

Second, creating a separate and distinct department and a department head creates a risk that the compliance personnel (whether trained as lawyers or not) will be viewed as another cost center. Granted, there is increased emphasis on compliance departments and right now corporations appear to be willing to spend the money—lots of money—to beef up their compliance function.[240] However, compliance will constantly have to prove its worth (and compete for limited resources). And just because it is not housed under the general counsel, does not mean it will not be housed within a different department (such as operations or enterprise risk management ("ERM"))[241] or under a different corporate executive like the CFO.[242] These entities may create roadblocks for compliance initiatives that eat at the bottom line or view compliance as just

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Tom Rollauer, Director, Deloitte & Touche LLP, as stating that, "[t]he role of the chief compliance officer has been elevated [and] is now, typically, an official member of the C-suite . . . whereas in the past it was often sort of a subpart of the legal division . . ."). *See also supra* notes 45 and 46 and accompanying text.

238. *See* Chambliss & Wilkins, *supra* note 25, at 582 ("[T]he most important source of credibility for . . . [in-house] specialists is the visible support of firm leaders."); *see also* Raymond, *supra* note 43, at 168 (urging that specialists receive "adequate compensation, institutional respect, and appropriate authority"). However, it may be that merely symbolic appointments might also lead to creation of a culture of compliance. *See* Chambliss, *Nirvana*, *supra* note 110, at 140–41 ("Management's values are not ultimately determinative of the specialist's influence. For instance, if the specialist is personally committed to promoting compliance with formal rules, a merely symbolic appointment may lead to conflict, mobilizing previously passive constituents inside and outside the firm.").

239. *See supra* note 46 and accompanying text. The power and influence of the CFO might also come into play. *See infra* notes 242, 291–292.

240. *See supra* note 131. *See also* Richards, *Instilling*, *supra* note 17; Richards, *New Compliance Rule*, *supra* note 17 (discussing the costs associated with the new rules requiring buttressing the compliance department as required by the Compliance rule); U.S. Sec. & Exch. Comm'n Press Release No. 204–164 Sec Adopts Rules Requiring Payment Disclosure By Resource Extraction Issuers (Aug. 22, 2012), *available at* http://www.sec.gov/rules/final/2012/34-67717.pdf (discussing the costs associated with the new compliance rule); *cf.* Krawiec, *supra* note 2, at 533–34; *see also* Boehme, *supra* note 128 (reporting that JP Morgan will pay $4 billion to beef up its compliance function).

241. "Enterprise risk management (ERM) is a management approach that holistically manages risks across the organization." Donald Pagach & Richard Warr, *The Characteristics of Firms that Hire Chief Risk Officers*, 2 (2010), *available at* http://ssrn.com/abstract=1010200.

242. Compliance is about adherence to the spirit and letter of the formal rules that are often laws but they can also be accounting rules. Heineman, *Don't Divorce the GC*, *supra* note 19, at 49. *See infra* note 290.

another risk to be "managed."[243] Also, it is not clear that the employees of a corporation will believe the commitment is "real" if the corporation creates a distinct compliance department because it is forced to or does so to receive future leniency from the government.[244] Thus, the head of a cost center that is continually trying to prove its worth may actually have less clout than the head of the legal department (also a cost center) that has already to some degree proven its worth and increased its stature over the years.[245]

Third, creating a separate and distinct department and department-head creates a risk that the compliance personnel (whether trained as lawyers or not) will be viewed as separate and, as such, as "outsiders," (as in-house counsel once were)[246] and lose their ability to be what Parker calls "persuasively relevant."[247] Many of the chief compliance interviewees in the Compliance Study expressed

243. Pagach & Warr, *supra* note 241, at 2 (finding results that support hypothesis that "that firms adopt ERM for direct economic benefit rather than to merely comply with regulatory pressure"); *id.* (finding "that firms that are larger, have more volatile operating cash flows, and greater institutional ownership are more likely to initiate an ERM program. In addition, when the CEO has incentives to take risks (through compensation), the firm is also more likely to hire a [chief risk officer] CRO."). A couple of the chief compliance interviewees reported to operations and enterprise risk management. *See supra* note 110. Some compliance officers may attempt to manage their departments as profit centers, to add value to the corporation. Rosen, Risk Management, *supra* note 20, at 1167. This stance, however, could make monitoring risks difficult if combined with an organizational structure where the compliance professionals work on teams. As one chief compliance officer (who also oversees an ERM program) explained, "[I]t's . . . trying to have that upside [of risk] and revenue generating kind of mantra and trying to find new things out there to just come up with that stuff as well too. So yeah, it's both. I mean we do that analysis. We look at our credit losses and our risk management cycle expenses and add that up and then apply that against this other stuff and show that we do—we are kind of a revenue generating positive aspects of the company." Telephone Interview with Interviewee Stage 2 CCO7 at 5; Rosen, *Risk Management*, *supra* note 20, at 1168–69; *id.* at 1180 ("[A]s a result of corporate redesign, compliance officers have become risk-managers. Compliance officers' zeal is re-shaped. A crucial consequence is that noncompliance becomes an option. Risks are not always eliminated; they often are transformed, hedged, and insured.").

244. Indeed, one of the interviewees (a former compliance monitor) gave at least two examples where compliance departments were dismantled as soon as the time period for the consent decree had passed. Telephone Interview with Interviewee Stage 2 CCO3 at 11–12; *see also* Ford & Hess, *supra* note 25, at 515 (explaining that the only way to ensure that a corporation continues to focus on its culture of compliance once the requirements of the consent decree have been fulfilled is for the corporation to have "buy in").

245. *See supra* notes 45–46 and accompanying text. *See also* Raymond, *supra* note 43, at 168 (pointing out that appointment of a compliance specialist that is undervalued or does not have the requisite authority may signify management's lack of support for the appointment which could result in pushing culture in the opposite direction of a culture of compliance). There is also the risk that appointment of a chief compliance officer and departmentalization will be counterproductive if employees view these moves as a way to protect upper management from future blame for corruption. Linda Klebe Treviño, et al., *Managing Ethics and Legal Compliance: What Works and What Hurts*, CAL. MGMT. REV. 131, Winter 1999, 131, 131–51.

246. Nelson & Nielsen, *supra* note 183, at 477; *see supra* notes 45–46 and accompanying text.

247. *See supra* note 47.

that they were viewed, at times, as "cops,"[248] or "watchdogs."[249] One chief compliance officer exclaimed dryly: "I think compliance is the world's longest four letter word and it initiates a response in people that is negative."[250] As such "compliance officers are often seen as outsiders, not good team players."[251] Employees are afraid to invite the chief compliance officer to the table. As many compliance officer interviewees bemoaned, "people are afraid to talk to you or invite you to table because we are not obligated to keep confidences and they understand that there is no privilege."[252] Separating the

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248. Telephone Interview with Interviewee Stage 2 CCO4 ("Now, the reason compliance organization is seen as corporate cops is, because if the local business doesn't follow protocol and they are out of line in terms of their monitoring activity and so forth, then the compliance organization has an obligation to report up the senior management. So in that regard, we would be seen as corporate cops."); Telephone Interview with Interviewee Stage 2 GC5 at 10 ("So our [chief compliance officer/associate general counsel] is sort of the go to on significant compliance issues and I certainly think people view her little bit as the cop;"); Telephone Interview with Interviewee Stage 2 CO13 at 13 ("I think it depends on who you talk to on what day because, you know, quite frankly there are lot of sales representatives who view me as I would say, Philadelphia cops in the 70's, you know, where I'm coming and if you are in my way you probably are going to get beaten. You are going to get beat up and then you are going to get arrested for resisting arrest.").

249. *See* Hurt, *supra, note* 132 ("Now in-house watchdogs . . . are required at all these companies."); *see also* Chambliss, *Nirvana*, *supra* note 110, at 140 (explaining that some corporate counsel and law firm counsel may play the role of "cop" in their firms, a "specialists influence on individual compliance does not depend on direct enforcement of ethics rules or firm policy").

250. Telephone Interview with Interviewee Stage 2 CO3 at 7; Telephone Interview with Interviewee Stage 2 FGC3b at 1 (explaining that it is "human nature to hate the word 'compliance'").

251. Telephone Interview with Interviewee Stage 2 CO3 at 7. A running theme in the Compliance Study interviews was that CCO is a tough and lonely job. *See infra* note 261. Also, it is consistent with surveys of compliance officers. *See "Stress" Taking a Heavy Toll on Compliance Ethics Professionals*, SOC'Y OF CORP. AND ETHICS (Jan. 10, 2012, 11:31 AM), http://www.corporatecompliance.org/Resources/View/ArticleId/321/-Stress-Taking-a-Heavy-Toll-on-Compliance-and-Ethics-Professionals.aspx (finding that sixty percent of CCOs consider leaving their jobs).

252. Telephone Interview with Interviewee Stage 2 CO3. Although it is true that confidences will only be privileged if the purpose of the conversation with the lawyer was primarily to receive legal advice and services, the fact that there is absolutely no hope of privilege in a conversation with a chief compliance officer could prevent the initial communication from occurring because the compliance officer may be seen as an enemy. *See* Snyder, *supra* note 187, at 239 (pointing out the risks of lawyers being seen as "enemies" when the potential for attorney-client privilege is eroded). This is problematic if it is true (as some believe) that the existence of the privilege motivates employees to share information so that the employee can be counseled to comply with the law. This is often a primary justification used by courts in support of applying for the corporate attorney client privilege. NXIVM Corp. v. O'Hara, 241 F.R.D. 109, 125 (N.D.N.Y. 2007) ("The free flow of information and the twin tributary of advice are the hallmarks of the privilege. For all of this to occur, there must be a zone of safety for each to participate without apprehension that such sensitive information and advice would be shared with others without consent."); Hercules, Inc. v. Exxon, Corp., 434 F. Supp. 136, 144 (D. Del. 1977) ("In a society as complicated in structure as ours and governed by laws as complex and detailed as those imposed upon us, expert legal advice is essential. To the

compliance function from the legal department could exacerbate this attitude. As the spotlight continues to focus on corporate malfeasance and emphasis continues to be placed on the role and reporting obligations of the compliance function at large publicly traded corporations, the chief compliance officer may become more disenfranchised.[253]

2. *Capability and Effectiveness*

a. Collaboration and Creative Problem Solving

Although many general counsel and chief compliance officers talk about the close relationship that they have and are dedicated to maintaining between them,[254] one common identified risk of departmentalizing compliance and legal is what could be labeled as a threat of "turf wars." That is, there exists a risk of overlap between the compliance and legal function that may result in rivalry between departments as they compete for power, influence, and limited resources.[255]

As Wilkins points out:

> [a]lthough creating a separate 'compliance counsel' might prevent the legal profession from losing market share to these new competitors (many of whom, [Tanina] Rostain notes, are themselves lawyers), it might also entrench the

furnishing of such advice the fullest freedom and honesty of communication of pertinent facts is a prerequisite. To induce clients to make such communications, the privilege to prevent their later disclosure is said by courts and commentators to be a necessity."). That corporations are willing to turn over privileged information in order to appease the government but at the same time use the attorney-client privilege to convince employees to share information is a conflict much debated as is whether the attorney-client privilege should be applied to corporations at all. *See, e.g.*, Vincent C. Alexander, *The Corporate Attorney-Client Privilege: A Study of the Participants*, 63 ST. JOHN'S L. REV. 191, 222–28 (1989) (reviewing the debate); *see also* David Luban, LAWYERS AND JUSTICE: AN ETHICAL STUDY 206–34 (1988) (explaining why the privilege should not be applied to corporations); John E. Sexton, *A Post-*Upjohn *Consideration of the Corporate Attorney-Client Privilege*, 57 N.Y.U. L. REV. 443, 464–68 (1982) (outlining the risks and benefits of applying the attorney–client privilege to corporations).

253. See Part V. A for a more detailed discussion of the importance of interdependence and collaboration to the level of influence and power of the chief compliance officer.

254. *See, e.g.*, *Stress, Compliance, and Ethics*, SOC'Y OF CORPORATE COMPLIANCE AND ETHICS & HEALTH CARE COMPLIANCE ASS'N, Jan. 2012, *available at* http://www.hcca-info.org/Resources/View/ArticleId/194/Stress-Compliance-and-Ethics.aspx (finding that eighty percent of respondents scored the relationship between compliance officers and legal as a 4 on a 1 to 5 scale); *see infra* note 385 and accompanying text.

255. *Cf.* Kraweic, *supra* note 2, at 533–34; *cf.* Rosen, *supra* note 20, at 1166 (describing the fight for limited resources among teams in the new corporation that has less hierarchical control); *see also* Heineman, *supra* note 24, at 2 (explaining that it may cause "turf-fighting"). *Cf.* Parker, *supra* note 1, at 339 ("In-house corporate lawyers are claiming the area of preventative law as their own."); *see, e.g.*, Interviewee Stage 1 GC20.

> kind of turf wars that will only work to obscure the fundamental purpose underlying these regulatory schemes—that achieving effective compliance is the joint responsibility of legal and business professionals.[256]

Although it could be that turf wars and competition for work increases the number of people that are passionate about compliance and the intensity of their interest, these turf wars may decrease the compliance officer's ability to access information in an efficient way. For example, if there is competition between the departments, information may not be freely shared and collaboration might be impeded. Indeed, this might be true even if turf wars do not exist. Once the departments are separated, it may simply be harder to share information.[257] Thus, there is a risk of less communication and a loss of shared earnings that may be more automatic when the two departments share a reporting structure or are aligned organizationally.

Moreover, if corporate directors are independent and treated as outsiders they may be less knowledgeable about what is happening on the inside and decision-making may be impaired.[258] The segmentation arguably removes those in compliance from daily interaction and makes them even less cognizant of the invisible social networks of communication that make a corporation work.[259] As many of the interviewees explained, knowing what is happening and having people feel like they can come to you and communicate informally is essential to identifying potential compliance issues before they get out of hand.[260] And independence (and access to the board) can have the opposite effect. The chief compliance officer may be seen as a spy or a cop instead of a concerned counselor. Thus, the chief compliance officer may be ostracized. Many of the chief compliance interviewees talked about how lonely it was to be a chief

256. Wilkins, *Rivals*, *supra* note 49, at 2131–32 (explaining that it is "necessary to move beyond a regulatory focus that assumes that gatekeeping duties are the sole responsibility of a single actor").

257. *See infra* Part V discussion around social networks.

258. Further, when groups or individuals are isolated, there is an increased chance that norms that are not in line with the organization's desired values will develop. BAZERMAN & TENBRUNSEL, *supra* note 128, at 165.

259. See *infra* discussion in Part V about the importance of internal social networks to understanding corporate culture. While one might argue that this is true of legal departments as well, legal departments have been around for ages and general counsels are now a part of the executive management team at large publicly traded corporations.

260. *See* Interviewee Stage 2 CCO8 at 23 ("[O]ur goal is, when there is a problem in the [company] and someone in the senior administrative team is aware of it, my ideal scenario is, they get up, they walk down the hall, they sit down in the Compliance Officer's office, and they say, we have a problem and I want you, I want your opinion on it, and I want your help on solving it. That's what we drive everything towards, that that is comfortable, that that is an environment in which they can feel good about doing that.").

compliance officer, how little they can share, how rarely they can trust what someone is saying to them and why.[261] It is, as Toni Morrison describes, a "loneliness that roams. . . . A dry and spreading thing that makes the sound of one's own feet going seem to come from a far-off place."[262] This raises the issue of identity and connectedness. Christine Parker claims that compliance professionals are more effective when they identify with a community of compliance professionals and regulators.[263] It is not necessary to this group identification, however, for the compliance department to be separate from the legal department – in a "far-off place." Indeed, it may be just the opposite, given that one could describe the legal department as a community of "gatekeepers."[264] Being a part of this gatekeeping community might have many benefits—especially if combined with the power to report to the board.[265]

Separate compliance departments, like walled off silos, are antithetical to research that stresses the importance of open environments that enable cross-fertilization between disciplines and that bridge different departments and units together.[266] First, such open environments have been shown to lead to more innovation.[267] Indeed, one study of intra-firm and inter-unit networks suggests that

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261. *See* Interviewee Stage 2 CXO15 at 9 (analogizing the role of Compliance Officer to Internal Affairs because it is often so lonely); *see* Interviewee Stage 2 CGO2 at 20–21 ("Some people think you are just a pain in the ass that's preventing them from . . . doing . . . what they want.").

262. TONI MORRISON, BELOVED 274 (1987).

263. Parker, *supra* note 1, at 348; *see* Braithwaite, *supra* note 228, at 327–54; J. Rees *Reforming the Workplace: A Study of Self-Regulation in Occupational Safety* (Univ. of Pa. Press, Philadelphia) at 43–44 (1988).

264. *See supra* Part IV.D.2 discussion of lawyers as gatekeepers.

265. *See also* Heineman, *supra* note 24, at 3 (making similar a point). In other words, the compliance officer can report to the general counsel and also have dual reporting lines to the board of directors.

266. Martin Reuf, *Strong Ties, Weak Ties and Islands: Structural and Cultural Predictors of Organizational Innovation*, INDUSTRIAL CORPORATE CHANGE 11, no. 3 (2002): 427, 430; *id.* at 445 (suggesting that entrepreneurs can create innovation by "diversifying their networks to include a wide range of social contacts").

267. STEVEN JOHNSON, WHERE GOOD IDEAS COME FROM, THE NATURAL HISTORY OF INNOVATION 162, 166, at 166–67 (describing a similar study by a professor at the University of Chicago business school who researched innovation at Raytheon Corporation and found that "innovative thinking was much more likely to emerge from individuals who bridged 'structural holes' between tightly knit clusters."); R. M. Kanter, WHEN A THOUSAND FLOWERS BLOOM: STRUCTURAL, COLLECTIVE, AND SOCIAL CONDITIONS FOR INNOVATION IN ORGANIZATIONS (1988); B. M. Staw & L. L. Cummings (Eds.), *Research in organizational behavior*, Vol. 10: 169-211; Bruce Kogut, & U. D. O. Zander, *Knowledge of the Firm, Combinative Capabilities and the Replication of Technology*, ORGANIZATION SCIENCE, Vol 3. No. 3, 389 (1992) ("It is the sharing of a common stock of knowledge, both technical and organizational, that facilitates the transfer of knowledge within groups."); *id.* at 391 ("New learning, such as innovations, are products of a firm's combinative capabilities to generate new applications from existing knowledge.").

there is a positive correlation between the extent of information and resource exchange between firm units with innovation.[268] Second, such intra-firm and inter-unit collaboration has been shown to increase efficiency and enhance problem solving. Consider the more recent emphasis by corporations to take a Kaizen-like approach to work. For example, Apple employs what is called "concurrent or parallel production"—all the different departments involved in a development cycle (from design to engineering, to marketing) meet continuously to exchange ideas, identify problems, and share solutions.[269] In other words, they cocreate. This Kaizen-like approach is accredited with increasing efficiency and market power.[270] Although these studies show that multidisciplinary and multifunctionary cooperation is possible even if the parties involved are not organized within the same unit, because of the turf wars and the job of a compliance officer to uncover and report misconduct, departmentalization may create barriers to just that type of cooperation and interdependency that is needed between departments.[271]

Innovation and creative problem solving is essential to being an effective compliance manager.[272] Without collaboration with others, the ability to creatively solve compliance issues may decrease. And there may be a benefit to collaborating with lawyers (or other executives) who may counterbalance extreme compliance attitudes and protocols that impede innovation in product development.[273]

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268. Tsai & Ghoshal, *supra* note 383, at 473 ("Our analysis suggests that investing in the creation of social capital inside a firm eventually creates value. Informal social relations and tacit social arrangements encourage productive resource exchange and combination and thereby promote product innovations.").

269. Johnson, *supra* note 267, at 162, 171.

270. Roya Behnia, *Legal Kaizans and Getting Lawyers to Solve Simple Problems Together, The New Normal* (Nov. 2, 2011), *available at* http://www.abajournal.com/legalrebels/article/getting_lawyers_to_solve_simple_problems_together/?utm_source=maestro&utm_medium=email&utm_campaign=weekly_email (last visited Mar. 9, 2013).

271. *See supra* Part IV.B.I.

272. Parker, *supra* note 1, at 345 ("Good compliance work means being constantly inventive in finding ways to persuade the rest of the business that ethically and legally responsible action is consistent with business goals.").

273. *See, e.g.*, Richard A. Epstein, *Throttled by Compliance*, DEFINING IDEAS (Mar. 2, 2011), http://www.hoover.org/publications/defining-ideas/article/69086 (arguing that excessive regulations can cause corporations to displace creative and entrepreneurial executives with the "dull masters of compliance" who are "not necessarily good at launching new companies, developing new drugs, or forging employee relations"); *Tangled Up in Green Tape*, THE ECONOMIST, Feb. 18, 2012, http://www.economist.com/node/21547804; *see also* Tyler Cowen, *Can I See Your License, Registration and C.P.U.?*, N.Y. TIMES, May 28, 2011, http://www.nytimes.com/2011/05/29/business/economy/29view.html?_r=0 (arguing that much-needed technological advances in transportation, namely the driverless car, are hitting major roadblocks because of heavy government regulation); *Robert Half Survey: Lack of New Ideas, Red Tape Greatest Barriers to Innovation*, PR NEWSWIRE (Apr. 4, 2012), http://www.prnewswire.com/

Further, cross-functional collaboration is an essential ingredient to a robust compliance program. For example, compliance needs to work closely with the finance and accounting departments among others.[274] As the interviewees in the Compliance Study pointed out, compliance programs in any large public company (regardless of industry) requires collaboration to develop, advertise, and implement. Compliance officers cannot do their job without securing the cooperation and commitment of employees to legal and social responsibility, and business goals are threatened if the business is not kept in compliance. Parker's research on compliance supports this view as well. Based on more than thirty in-depth interviews with compliance professionals in the U.K., U.S., and Australia, she conceptualizes the ideal approach to advising corporations on regulatory compliance. These new 'ideal' compliance professionals take "an ethical stance of interdependence"[275] in which they view themselves as "citizens of the corporation, not independent advisors of it."[276] In keeping with that, many of the interviewees explained that although it keeps them up at night, they cannot ensure that employees are complying with the law and they accept that every single day someone may not be complying. The aim, however, is to

> facilitate and empower others in the business to "do compliance" by working with a variety of other managers and professionals in the company, to translate law into commonsense. Most significantly, compliance professionals continually attempt to "cascade" responsibility for compliance down through the line management, so that a culture of compliance commitment permeates the organization.[277]

In sum, while it is true that collaboration can occur despite reporting lines, an unofficial mandate to separate compliance from legal emphasizes independence and separation as opposed to interdependence and collaboration which have been shown to lead to

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news-releases/robert-half-survey-lack-of-new-ideas-red-tape-greatest-barriers-to-innovation-146074815.html (reporting that in a survey of 1,400 CFOs, 24 responded that too much bureaucracy was the greatest barrier to innovation at their respective companies); http://rhfa .mediaroom.com/file.php/1225/innovation-infographic.gif]; *but see infra* discussion regarding the lightning rod salesman approach of lawyers.

274. *See, e.g.*, Mary Bachinger, *The General Counsel and the CFO: Partners in Compliance*, http://www.nacubo.org/Business_Officer_Magazine/Business_Officer_Plus/Bonus_Material/The_General_Counsel_and_the_CFO_Partners_in_Compliance.html (last visited Aug. 29, 2013). *See supra* notes 239–242. *See infra* notes 291–292.

275. Parker, *supra* note 1, at 340.

276. *Id.* at 345; *Id.* at 346 ("[C]ompliance officers cannot be autonomous and aloof from the business; they must be seen as very much a part if the business.").

277. Parker, *supra* note 1, at 346.

more efficient, effective results and better problem solving and arguably, are essential to effective compliance.[278]

b. Skills and Expertise

There is no reason to believe that an independent chief compliance officer will have a better set of compliance skills or expertise than a chief compliance officer who reports to the general counsel.[279] As discussed earlier in Part I, compliance officers are in charge of building policies and procedures and training programs that are designed to monitor, detect, and prevent noncompliance. To effectuate these programs, compliance officers need to understand HR issues, manage people, work in teams, work with audit, be exemplary communicators, and employ financial and project management skills. Common lore among lawyers and compliance officers is that lawyers don't know how to "do" these things.[280] They do not know how to "do" compliance. A typical statement by a general counsel interviewee was "general counsels are struggling—scratching their heads wondering how do we do this compliance—I know laws but I don't know jack about process."[281]

Further, some contend, like Robert E. Rosen and Parker that there is a lawyer "cast of mind" that may not aid but may actually impede compliance initiatives. In a recent research study comparing lawyer-led compliance programs with non-lawyer led compliance departments, Rosen *et al* found that lawyers are "followers: they follow their company's normative orientation. When companies are committed to compliance, lawyers in charge of compliance structure their company's compliance practices and behaviors accordingly" but "when companies are not committed to compliance, lawyers do not

278. *See generally* Michele DeStefano, *NonLawyers Influencing Lawyers: Too Many Cooks in the Kitchen or Stone Soup?*, 80 FORDHAM. L. REV. 2791 (2012); *see also* Parker, *supra* note 1 *but see* note 294.

279. I am supportive of having compliance established as a department but do not agree that it is necessary to prevent general counsel oversight of the compliance department. *See supra* note 43. Rostain, *supra* note 19, at 493.

280. *See, e.g.*, Daniel Currell & M. Todd Henderson, *Can Lawyers Stay in the Driver's Seat?*, University of Chicago Institute for Law and Economics Working Paper Series Index, at 1–2 (Jan. 16, 2013), *available at* http://www.law.uchicago.edu/Lawecon/index.html http://ssrn.com/abstract=2201800 ("Lawyers don't generally have sophisticated . . . project management and commercial skills.").

281. Interviewee Stage 2 CCO4 at 3; *see also* SCCE Study March 2013, *supra* note 10, at 4 ("There are also key skills for a CCO that a GC may not necessarily have (project management, presentation) and the advisory role of Counsel doesn't always mesh well with the CCO role.") (quoting compliance professional survey respondent); *see, e.g.*, Rostain, *supra* note 19, at 481 (reporting that "the GC of a food processing company," claimed that "accountants and business people were better suited at setting up compliance systems than lawyers").

. . . promote compliance" and "may even aid their clients to resist and subvert regulation."[282] Thus, they find that lawyers can behave as "gamesters" treating the law as "a game of loopholes" and litigation as unavoidable.[283] Similarly, others contend that lawyers take an "excessively legalistic approach" to compliance that obscures the "cultural influences that impact employee behaviors or nuances."[284]

Although the type of professional selected to lead compliance may reflect a firm's compliance culture and objectives (to reduce uncertainty or to increase legitimacy),[285] research indicates that what makes a difference is if the compliance professional is a "compliance specialist," an expert in running compliance initiatives.[286] The governmental mandates to separate compliance from legal do little to ensure that compliance specialists are leading compliance. As discussed, secondary literature (supported by Compliance Study data) indicates that these new compliance departments are often led by and comprised of lawyers (even if they are not considered practicing lawyers). There is no reason to believe that a lawyer's "cast of mind" (if it exists) will be erased simply because the lawyer has been moved from the legal department to an independent compliance department. To that end, corporate senior management can appoint any person as the chief compliance officer. Indeed, they can select based on attitude, ideology, level of influence, and behavior.[287]

Thus, it is not clear that the unofficial governmental mandate will change the current status quo. However, the status quo might change in a different way if departmentalization means that more lawyers

282. Rosen et al., *supra* note 211, at 4 (summarizing research results from Rosen et al., *supra* note 25).

283. Rosen et al., *Followers*, *supra* note 211, at 3.

284. John P. Hansen, *Corporate Counsel Perspective: The Crisis of Ethics and the Need for a Compliance-Savvy Board, Remarks at the Rand Center for Corporate Ethics and Governance Conference* (May 12, 2000), *in* CONFERENCE PROCEEDINGS: DIRECTORS AS GUARDIANS OF COMPLIANCE AND ETHICS WITHIN THE CORPORATE CITADEL: WHAT THE POLICY COMMUNITY SHOULD KNOW 41, 44, available at http://www.rand.org/content/dam/rand/pubs/conf_proceedings/2010/RAND_CF277.pdf.

285. Rosen et al., *supra* note, 211, at 16.

286. *Id.*, ("[M]ore fulsome compliance structures . . . are present when the department is headed by a compliance specialist."); *id.* ("[T]he professional background of the individual responsible for compliance has little impact on a company's compliance management structures and practices or assessment of stakeholders.").

287. A similar argument has been made against the Sarbanes Oxley requirement around independent directors. *See, e.g.*, Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817, 1847–49 (2007) ("The weak spot in the independence movement has always been that a company's senior management dominates the selection of independent directors, which means management can select for certain attitudes and preferences."). Of course, this cuts both ways. That this is possible may mean that senior management (in choosing the right type of compliance officer) can side step some of the potential negative consequences discussed in this Part around power, influence, and connectedness.

working in compliance do not consider themselves bound to the Model Rules of Professional Conduct.[288] Currently, some general counsels that oversee compliance believe that (despite whether the attorney-client privilege would apply) that:

> [t]here is NO such thing as a non-practicing lawyer—purely practical—if you are a lawyer you are a lawyer. It doesn't matter if you are licensed to practice law or not. People look at you as a lawyer and rely on you as it and believe you dispense legal advice despite title . . . and therefore, in my view, I'm a GC of a company if one my lawyers screws up, I'm responsible. I can't say that's a lawyer in compliance and I get a "by" . . . I think that is functionally wrong . . . .[289]

If the compliance officer or compliance professionals are not structurally considered a part of the legal department, they might not have the attitude displayed in the quote above. If so, legally trained compliance professionals might not consider themselves bound by the professional norms. In that scenario, these legally trained compliance professionals may actually have just enough information, training, power, and "cast of mind," to do more bad than good.[290]

Further, despite the development of a new, independent department, there may be a decrease of substantive expertise dedicated to compliance. As the former General Counsel for General Electric, Ben W. Heineman Jr., blogged recently, "compliance is not one substantive subject, it is many: competition law, employment law, environmental law, labor and employment law, international law, accounting rules, and disclosure law."[291] Since the

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288. This would be the case if they clearly communicate to their clients that this is a law-related service that does not procure the benefits of the lawyer-client relationship. Model Rule of Professional Conduct 5.7.

289. For a discussion about the possibility of compliance professionals violating unauthorized practice of law ("UPL") statutes *see* DeStefano, *supra* note 127.

290. These compliance professionals would add to the growing industry of "law consultants" not necessarily part of a profession. *See generally* Tanina Rostain, *The Emergence of 'Law Consultants,'* 75 FORDHAM L. REV. 1397, 1399 (2006) (considering "the effects that law consulting might have on the interests and values that professional regulation is intended to protect"). *See generally* CHRISTINE PARKER, *supra* note 25. *See also* DeStefano, *supra* note 127 (discussing the risks associated with these law consultants as it relates to the fields of compliance and litigation funding); Dana A. Remus, *Out of Practice, the 21st Century Legal Profession*, __ DUKE L. J. __ (forthcoming 2013) (contending that quasi-legal roles "create[] opportunities for abuse by individual lawyers who seek to evade ethical obligations, and for ethical arbitrage by sophisticated corporate clients who seek to access legal expertise without the strictures of professional regulation.").

291. *See* Heineman, *supra* note 19, at 1–2; *see also* Heineman, *supra* note 19, at 1 ("[I]t makes no sense for the chief compliance officer to be "independent" and to hire the various substantive experts who must work on compliance but also on business problems for the GC and CFO. That doesn't amount to appropriate "checks and balances," but is a source of bureaucratic waste, confusion, and possible turf-fighting."). It may also prove to elicit opinion

substantive legal experts in all of these subjects already report to the general counsel, "[i]t makes absolutely no sense to duplicate that expertise by having a second set of experts who report to the chief compliance officer."[292]

Further still, such duplication would be an extremely costly endeavor. There is already concern over costs associated with designating a chief compliance officer and creating a compliance department[293]—let alone attempting to replicate the range of substantive expertise in the legal department. Thus, it is not likely that corporations will actually duplicate expertise. If that is the case, and there are communication gaps between the departments, substantive expertise housed in the legal department may not be leveraged in the compliance department. Separation, therefore, could lead to an increase (as opposed to decrease) in compliance transgressions.[294]

C. CORPORATE TRANSPARENCY

There is a belief that enhanced corporate transparency will result in enhanced corporate ethics and responsibility.[295] To that end, an argument in favor of departmentalization is that separating

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shopping. Compliance Study Interviewee, FGC3b at 2.

292. Heineman, *supra* note 19 at 2. Many corporate failures have resulted from fraud in accounting or other financial rules. Thus, the compliance function likely also needs to have financial expertise or a close working relationship with the CFO, auditors, and comptrollers. Compliance Study Interviewee, FGC3b at 2.

293. Richards, *supra* note 17.

294. On the other hand, as William H. Widen pointed out in reviewing a draft of this Article, a regulatory scheme that required a duplication of the compliance function in the legal and compliance departments might result in more compliance because it would set up a competition between the legal department and separate compliance office. Of course, this might also exacerbate the issues stemming from turf wars discussed in Part IV.B.2.

295. *See* BARBARA KOWALCZYK-HOYER, TRANSPARENCY IN CORPORATE REPORTING: ASSESSING THE WORLD'S LARGEST COMPANIES 4 (2012), http://files.transparency.org/content/download/459/1891/file/2012_TransparencyInCorporateReporting_EN.pdf (last visited June 11, 2013) (stating that, "[b]y adopting greater corporate transparency—publicly reporting on activities and operations—companies provide the necessary information for investors, journalists, activists and citizens to monitor their behavior); *cf. generally* Antonino Vaccaro & Joan Fontrodona, *The Myth of Corporate Transparency*, THE ECONOMIST ONLINE, Sep. 7, 2010, http://www.economist.com/blogs/newsbook/2010/09/myth_corporate_transparency (last visited June 11, 2013) (contending that this is a "fashionable" belief but that access to more information is not the solution); *see* H. Stephen Grace Jr. & John E. Haupert, *Corporate Governance: Lessons from Life and Litigation— With Implications for Corporate Counsel*, 85 N.Y. ST. B.A. J. 32, 33 (2013) (stating that checks and balances and transparency in an organization can create and foster an ethical environment); *see also* Langevoort, *Social Construction, supra* note 287, at 1828–33 (contending that the Sarbanes Oxley legislation around corporate governance can be interpreted to have the goal of increasing corporate transparency and accountability to the public).

compliance from the legal department weakens the application of the attorney-client privilege, and therefore, increases transparency into corporate conduct during corporate investigations and in response to government inquiries.[296] The reasoning is that the chief compliance officer and other officers in the department (even if they are legally trained) will have a weaker argument for privilege protection because they are not, organizationally, part of the legal department. The idea is that when the professional is not part of the legal department, it is harder to demonstrate that the professional is acting as a lawyer. However, this reasoning does not track with the doctrine.

The attorney-client privilege only applies to communications between lawyers and their clients for the purpose of providing legal advice and services.[297] In the case of compliance officers, regardless of their training or the department in which they sit, the common view is that compliance officers are not really acting as lawyers or providing legal advice and, therefore, cannot garner attorney-client privilege protection.[298] This is in keeping with views of SEC

296. Tabuena and Smith, *supra* note 85, at 14–15 (contending that a benefit of having the general counsel play the role of chief compliance officer is that "legal privileges and discovery protections readily apply and can be more easily managed").

297. Hickman v. Taylor, 329 U.S. 495, 508 (1947) (explaining that there is no expectation of confidentiality); Cavellro v. United States, 284 F.3d 236, 246 (1st. Cir. 2002); 8 WIGMORE, at § 2317 (McNaughton rev. 1961). The attorney-client privilege is considered waived when confidential information is shared with a third party. *Hickman*, 329 U.S. at 508; 8 JOHN HENRY WIGMORE, A TREATISE ON THE ANGLO-AMERICAN SYSTEM OF EVIDENCE IN TRIALS AT COMMON LAW § 2317. However, there are some exceptions to waiver. However, there are some exceptions to waiver. *See generally* Michele DeStefano Beardslee, *The Corporate Attorney-Client Privilege: Third Rate Doctrine for Third Party Consultants*, 62 SMU. L. REV. 727 (2009).

298. Richards, *New Compliance Rule*, *supra* note 17 ("Routine compliance monitoring is not subject to attorney-client privilege, and in particular . . ."). *See, e.g.*, Interviewee Stage 2 CCO5 at 17 ("What I tell people is that the compliance work, we should consider it probably not to be privileged. And so when I do my compliance work, I always make sure they would have work product [protection] and I tell my clients, because a lot of times my clients are the same."); *but see* CCO2 at 12 (claiming that even though the departments are separate and he does not report to the general counsel, there is an argument that the work he does is covered by the privilege); *id.* at 14

> ("We tell the lawyers in our group, in my compliance group, they're still lawyers they maintain a legal division title like, Senior Corporate Counsel or Assistant General Counsel or that type of thing even though they are no longer in the legal division and we do that for a multitude of reasons. We want to try to make it, it's good an argument, we can for privilege purposes, we do want to attract and retain the best people, we want people to be able to maintain bar requirements in terms of practicing law and the like and etcetera, etcetera.").

Note: this is the only interviewee that held this position. The work product doctrine can apply to materials created by a nonlawyer representative of the client or agent. RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 87 cmt. a (2000); FED. R. CIV. P. 26(b)(3); FED. R. CIV. P. 26(b)(3)(A); Occidental Chem. Corp. v. OHM Remediation Serv. Corp., 175 F.R.D. 431, 434 (W.D.N.Y. 1997); *see also* NXIVM Corp., 241 F.R.D. at 128. The work product doctrine protects tangible (and intangible) materials developed in anticipation litigation, trial, or

officials[299] as well as general counsels and compliance officers in the Compliance Study as exemplified by the following three quotes:

> The entire legal department which includes compliance, by the way, here does report up to me as the chief legal officer but we are organized across business lines as well . . . . We have a lot of attorneys in our law division who are in the compliance department. . . . Compliance is not part of the law . . . . We have to say they're working as compliance professionals, not lawyers but there's a godly number who have law degree.[300]
>
> I am a lawyer; but I am not acting as a lawyer, I'm not acting as an in-house lawyer on behalf of the company. There is sometimes some confusion within the Law Department itself as far as that distinction is concerned, and there is also sometimes confusion from internal clients that think, "Oh, I can just go . . ." straight to me to get legal advice; and I have to tell them, "I'm glad to talk to you, but I'm not acting as a lawyer; what we're talking about is not privileged; and if you want legal advice, you will probably have to go down the hall to somebody else.[301]
>
> And so this may be a little bit of splitting hairs; but I am technically not part of the Law Department. I report in to the General Counsel, Senior Vice-President. . . . General Counsel, Senior Vice President of Governmental Affairs and Corporate Secretary. He has different groups reporting to him. He's got Compliance, he's got the Law Department, he's got the Corporate Secretary's Office, and he's got Governmental Affairs; so he's got four different groups that report in to him. So I'm technically not part of the Law Department. I am a lawyer by trade; but I don't hold myself out as a lawyer representing the company, and I try not to be

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other type of an adversarial procedure. FED. R. CIV. P. 16(b)(3); FED. R. EVID. 502(g)(2) (providing that intangible materials are also protected by work product doctrine); Hickman, 329 U.S. at 511–12. For an overview of the history and contours of the work product doctrine *see* Michele DeStefano, *Taking the Business out of Work Product*, 79 FORDHAM L. REV. 1896, 1890–909 (2011); for a review of the differences between the attorney-client privilege and work product doctrine, *see* Beardslee, *Third Rate, supra* note 296, at 755–59. At least one interviewee that was an ex-deputy GC believed that there may be a chance for privilege protection under the argument that a compliance officer who is a lawyer can be acting as a lawyer in the compliance role. Interviewee Stage 2 CCO1. It is unclear whether a court would give credence to that argument.

299. Richards, *New Compliance Rule, supra* note 17.

300. Interviewee Stage 1 GC28 at 2.

301. Interviewee Stage 2 CCO6 at 2.

providing legal advice, because I am acting in the position as Chief Compliance Officer rather than as an in-house lawyer for the company.[302]

Departmentalization by itself should not increase *or* decrease the potential of privilege protection. This is because regardless of who the chief compliance officer reports to or what department the chief compliance officer is in, the chief compliance officer is (supposedly) not "acting" as a lawyer (even if trained as one) and, therefore, cannot garner attorney-client privilege protection to shield information that is disclosed by corporate employees.

That said, departmentalizing compliance might make it more obvious that the chief compliance officer is not acting as a lawyer.[303] Contrary to common lore, clearly demarcating that the chief compliance officer is not acting as a lawyer may not lead to a *decrease* in the effective use of the attorney-client privilege to protect communications regarding corporate misconduct. Indeed, it might have the opposite effect. Here's why: Lawyer communications that mix business and law are protected by the attorney-client privilege as long as they are "predominantly legal"[304] or "made primarily for the purpose of generating legal advice."[305] Courts protect these mixed communications because it is almost impossible to distinguish between business and law[306] and even "the average lawyer—whether [in-]house or outside counsel—often mixes his legal advice with business, economic and political counsel."[307]

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302. *Id.*

303. This would also be true if the chief compliance officer was a nonlawyer in a compliance department overseen by the general counsel.

304. Zenith Radio Corp. v. Radio Corp. of Am., 121 F. Supp. 792, 794 (D. Del. 1954) ("When he acts as an advisor, the attorney must give predominantly legal advice to retain his client's privilege of non-disclosure, not solely, or even largely, business advice.").

305. McCaugherty v. Siffermann, 132 F.R.D. 234, 240 (N.D. Cal. 1990); United States v. United Shoe Mach. Corp., 89 F. Supp. 357, 359 (D. Mass. 1950) ("[T]he privilege of nondisclosure is not lost merely because relevant nonlegal considerations are expressly stated in a communication which also includes legal advice."); United States v. Int'l Bus. Mach. Corp., 66 F.R.D. 206, 212 (S.D.N.Y. 1974); *See supra* note 297.

306. *See, e.g.*, Sedco Int'l v. Cory, 683 F.2d 1201, 1205 (8th Cir. 1982); Diversified Indus., Inc. v. Meredith, 572 F.2d 596, 610 (8th Cir. 1977); Hercules, Inc. v. Exxon Corp., 434 F. Supp. 136, 147 (D. Del. 1977); 8 JOHN HENRY WIGMORE, A TREATISE ON THE ANGLO-AMERICAN SYSTEM OF EVIDENCE IN TRIALS AT COMMON LAW §§ 2317, 2296 (McNaughton rev. 1961); *see also, e.g.*, Ann M. Murphy, *Spin Control and the High-Profile Client—Should The Attorney-Client Privilege Extend to Communications With Public Relations Consultants?*, 55 SYRACUSE L. REV. 545, 581 (2005).

307. NXIVM Corp., 241 F.R.D. at 126; Rattner v. Netburn, No. 88-Civ-2080, 1989 U.S. Dist. LEXIS 6876, at *15 (S.D.N.Y. June 20, 1989) (alteration in original); United Shoe Mach. Corp., 89 F. Supp. at 360; John M. Burman, *Advising Clients About Non-Legal Factors*, WYO. LAW., Feb. 27, 2004, at 40 ("[C]lients are in search of help with problems which they perceive . . . to involve legal issues. But they generally want more. No legal problem arises in a vacuum . . . . A

However, determining whether the *primary purpose* for the communication was to ascertain legal advice or services is extremely difficult when a lawyer has dual responsibilities—as general counsels do.[308] Given the blurriness between the compliance and law functions, it is even more difficult in the scenario where the compliance officer acts as both a lawyer reporting to the general counsel and a compliance officer reporting to the CEO.[309] Specifically, when an attorney who reports to the general counsel is both a compliance officer and a lawyer, it is hard to prove that the primary purpose of any communication with the client (that may have contained both legal and compliance advice) was to garner legal advice.[310] Adding to the difficulty is that many courts, worrying that corporations are including in-house lawyers in communications simply to garner privilege protection,[311] require a higher level of proof that the communication was primarily for legal advice if the in-house attorney has legal and non-legal duties.[312] If the chief compliance

client usually wants, therefore, advice about how to resolve the problem, in general, and not just the legal aspects of it. Resolving a problem thus invariably involves non-legal issues."); Gregory Sisk & Pamela J. Abbate, *The Dynamic Attorney-Client Privilege*, 23 GEO. J. LEGAL ETHICS 1, 36 (2010) (contending that when "non-legal components of a communication are intertwined with genuine and material requests for or legal advice provided by corporate counsel, whether in-house or outside, the privilege should attach").

308. U.S. Postal Serv. v. Phelps Dodge Ref. Corp., 852 F. Supp. 156, 160 (E.D.N.Y. 1994); NXIVM Corp., 241 F.R.D. at 139; Michele D. Beardslee, *If Multidisciplinary Partnerships Are Introduced into the United States, What Could or Should Be the Role of General Counsel?*, 9 FORDHAM J. CORP. & FIN. L. 1, 15 (2003) ("[The] job is multi-disciplinary and cross-functional by nature."); *id.* at 20 ("Most General Counsel have a broad range of responsibilities and perform a mixture of legal and non-legal work."); Murphy, *supra* note 306, at 581 ("The problem is especially pronounced . . . if the attorney is in-house counsel. . . ."); United States v. Chevron Texaco Corp., 241 F. Supp. 2d 1065, 1069 (N.D. Cal. 2002) ("Because . . . attorneys . . . performed the dual role of legal and business advisor, assessing whether a particular communication was made for the purpose of securing legal advice (as opposed to business advice) becomes a difficult task."); Bufkin Alyse King, Commentary, *Preserving the Attorney-Client Privilege in the Corporate Environment*, 53 ALA. L. REV. 621, 623 (2002).

309. *See supra* Part III.B.

310. *See generally* Michele DeStefano Beardslee, *supra* note 297. Interestingly, the difficulty with claiming privilege when an officer has dual responsibilities as a lawyer and Chief Compliance Officer was identified by the SEC as a caution against the Chief Complaince Officer reporting to Legal. Richards, *New Compliance Rule*, *supra* note 17 ("If you decide that the Chief Compliance Officer will report to Legal, counsel will have to clearly articulate instances of client privilege and show great effort to segregate any dual responsibilities."). Interviews confirmed that compliance officers that are also lawyers often provide legal advice. Interviewee GC Stage1 #20 (the problem you often face is compliance officers giving legal advice—and it's hard for them not to do it sometimes, given the nature and scope of their jobs"); CCO2 at 12; *cf.* Parker, *supra* note 1, at 339 ("In-house corporate lawyers are claiming the area of preventative law as their own.").

311. First Chicago Int'l v. United Exch. Co., 125 F.R.D. 55, 57 (S.D.N.Y. 1989); Hercules, Inc. v. Exxon Corp., 434 F. Supp. 136, 143 (D. Del. 1977).

312. *In re* Sealed Case, 737 F.2d 94, 99 (D.C. Cir. 1984); Borase v. M/A COM, Inc., 171 F.R.D. 10, 13–14 (D. Mass. 1997); McCaugherty v. Siffermann, 132 F.R.D. 234, 241 (N.D. Cal.

officer is not and does not report to the general counsel and leads a department separated from the legal department, whenever the general counsel (or other attorney from the legal department) is in a meeting with the chief compliance officer or a compliance officer, there is a strong argument that the lawyer's communication was sought for the primary purpose to provide legal advice and services. True, confusion as to whether the compliance officer is providing legal advice may still exist after departmentalization (if the compliance officer is a trained lawyer). However, the division in roles and between departments supports the contention that the lawyer in the legal department is *not* acting as both legal and business advisor but instead included in the conversation to provide the "legal" point of view thereby enhancing the potential that the privilege will be applied.[313] As one chief compliance officer interviewee explained, "[a] lot of times I will retain Counsel to advise me or to help make sure that the work can be privileged."[314] Interestingly, although the government has often put into its consent decrees that a company "shall not assert a privilege to the OIG with respect to legal advice or

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1990); Elizabeth Chambliss, *The Scope of In-Firm Privilege*, 80 NOTRE DAME L. REV. 1721, 1727 (2004); *see* Murphy, *supra* note 306, at 581 ("[S]ome courts . . . have imposed a heavy burden on corporations seeking to protect communications with persons holding dual legal/nonlegal rules.") (internal citations and quotations omitted); Carl Pacini et al., *Accountants, Attorney-Client Privilege, and the Kovel Rule: Waiver Through Inadvertent Disclosure Via Electronic Communication*, 28 DEL. J. CORP. L. 893, 901 (2003); King, *supra* note 308, at 623. Some courts consider whether the communication expressly requests legal advice. Allied Irish Banks v. Bank of Am., 240 F.R.D. 96, 101, 104 (S.D.N.Y. 2007). Others courts consider if the communication would have transpired if the client did not need legal advice. See, e.g., Westinghouse Elec. Corp. v. Rep. of Phil., 951 F.2d 1414, 1423–24 (3d Cir. 1991); HPD Labs., Inc., v. Clorox Co., 202 F.R.D. 410, 415 (D.N.J. 2001); U.S. Postal Serv. v. Phelps Dodge Ref. Corp, 852 F. Supp. 156, 163–64 (E.D.N.Y. 1994); First Chi. Int'l, 125 F.R.D. at 57–58; Sexton, *supra* note 252, at 459.

313. Some might claim this moot because as interviewees often disclosed, "whether it's privileged or not, you are still going to want to turn the work over to the government to show that you've done something in good faith." Interviewee Stage 2 CCO5 at 17; *see also* Interviewee Stage 2 FGC3a at recent conference on corporate governance at which the Author presented ("When it's a high profile matter, GCs presume there is no privilege."). However, as a Chief Compliance Officer (who was formerly the Associate General Counsel) at a large pharmaceutical company explained, "[c]ompanies sometimes waive the privilege; very frequently you can make disclosures and do things in a matter that doesn't even calls you to, have to deal with the privilege. You just don't have to give all the privilege material, you can give over material that's not privilege that gives the government exactly what they need." CCO2 at 12.

314. Interviewee Stage 2 CCO6b at 17 ("And when we start off with an investigation, we do work closely with a lawyer, almost always have a lawyer involved with us in the investigative stages so that we can retain the attorney-client privilege as much as we can"); Stage 2 FGC3a at 2 (explaining that "unless you have the legal department involved in the beg with the corporate privilege you don't have it and once you don't have it, you can't get it back and you gotta have it set up so that it is set up as narrow as possibly can be and so that you don't give it up at the get-go").

counsel," many of these agreements state that "the Officer may seek legal advice from internal or external attorneys outside the Compliance Department without waiving any applicable privilege."[315]

Before departmentalization, a corporation might include an external lawyer in meetings in an effort to have a stronger argument for nondisclosure. After departmentalization, the corporation can achieve a similar benefit by including an in-house attorney in meetings—without the extra costs of hiring an external lawyer.[316] In this new structure, therefore, the in-house lawyer is serving in many respects like an outside counsel (perhaps depleting the need for outside counsel advice). True, if there are turf wars, as described above, departmentalization may segregate internal attorneys from compliance and prove an opportunity for more work for outside lawyers.[317] However, from a transparency standpoint,[318] the public doesn't benefit whether an internal or external lawyer plays this role.[319] Instead of increasing access to information around noncompliance so that criminal prosecution can be pursued, departmentalization may impede it.

D. ROLE OF CORPORATE LAWYERS

Proponents of departmentalization support their view by relying on role arguments. They define the lawyer's main role as providing legal advice related to the parameters of the law and advocating and defending against legal liability.[320] They differentiate this role from

315. Quest Corporate Integrity Agreement, *supra* note 148, at 5.

316. Of course, an external attorney does not face the same number of hurtles in proving that he/she was present for the primary purpose of providing legal advice.

317. Indeed, others have suggested that companies should be required to hire an independent outside attorney to review annual and quarterly disclosure documents and certify that the disclosures were not materially misleading. *See, e.g.*, Coffee, *supra* note 18, at 231; Wilkins, *Rivals*, *supra* note 49, at 2130 (making similar point). Coffee further proposes that without this review, inside lawyers could be sued for aiding and abetting their corporate client's fraud. *See, e.g.*, Coffee, *supra* note 18, at 231. Law firms have begun offering compliance support and services either directly or through ancillary businesses. For example, Baker and McKenzie created LawinContext PTE LTd, a separate business to offer online information, consulting, and training services for clients (and potential clients) based on industry needs. *See* Philip Marcovici & Victoria Dalmas, *Rationale and Organization of Practice Groups*, MANAGEMENT VON ANWALTSKANZLEIE EROFIGREICHE FUHRUNG VON ANWALTSUNTERNEGHMEN at 167–68 (2012). One of the industries it focuses on is tax and compliance services. *Id.* For a discussion of how law firms have evolved from practice group organization to industry groups, *see generally id.* at 163–70.

318. Transparency issues aside, there may be other reasons why the public might benefit from having lawyers at the table. *See supra* Part V about lawyers as lightning rod salesman and *infra* discussion around interdependence.

319. Of course, having external and/or internal lawyers involved in compliance matters may help create a culture of compliance or actual compliance. *See infra* discussion at Part IV. D.

320. *But see* Michele DeStefano Beardslee, *Advocacy in the Court of Public Opinion,*

the role of compliance professionals, which they contend is to uncover noncompliance and promote socially responsible and ethical behavior above what the law requires.[321] Further, they contend that lawyers are not able to create an ethical corporate culture based on a values approach because they are trained as lawyers and serve in the role of lawyers, and, therefore, take a too "legalistic approach,"[322] are too "zealous, aggressive, driven, [and] loyal."[323] Thus, they argue for departmentalization.

Although designating a specific department as keeper of the corporate moral compass is likely in the public's interest, there could be negative consequences to segregating this group from the legal department. First, counter intuitively, there may be less emphasis on risks. Second, separating the compliance function from the legal department may put lawyers in the role of legal technicians that will impede compliance with the spirit of the laws, ethical behavior, and a normative commitment to compliance and ethics. It is to these two potential consequences that the following sections turn.

1. *Role of Lawyers as "Lightning-Rod Salesmen"*

First, having compliance report to legal may increase the corporation's attention on risks, and, therefore, compliance. Although Rosen concluded that having a "lawyer cast of mind" might impede compliance, their findings also (perhaps contradictorily) support that a lawyer cast of mind might actually raise awareness of the risks associated with noncompliance and support corporations' adherence to practices that are above that required by the law. As

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Installment Two: How Far Should Corporate Attorneys Go?, 23 GEO. J. LEGAL ETHICS 1119 (2010) (claiming that the advocate role may not be defensible or appropriate in the corporate context).

321. GC Interviewee Stage 2 GC8 at 2 ("At the end of day—well the role of the general counsel is really to defend vigorously the interest of company whether right or wrong. Whether the company did something wrong or not, [the general counsel role is to] try to say the corporation did something right and to protect company. The chief compliance officer is there as a secondary check to provide the company with a moral compass."); *see also* SCCE Study March 2013, *supra* note 10, at 4 ("Legal's role is to protect and defend. Compliance's role is to uncover weaknesses, develop controls and mitigate risks. Uncovering weaknesses often poses a conflict within legal's role to protect.") (quoting compliance professional).

322. Hansen, *supra* note 284, at 44.

323. Langevoort, *supra* note 19, at 501 (making the same point). For a discussion about how the different types of lawyer personalities affect lawyers' ability to be leaders, *see* DEBORAH L. RHODE & AMANDA K. PACKEL, LEADERSHIP: LAW, POLICY, AND MANAGEMENT 41–56 (2011); *see also* Susan Daicoff, *Asking Leopards to Change Their Spots: Should Lawyers Change? A Critique of Solutions to Problems with Professionalism by Reference to Empirically Derived Attorney Personality Attributes*, 11 GEO. J. LEGAL ETHICS 547 (1998); Susan Daicoff, *Lawyer, Know Thyself: A Review of Empirical Research on Attorney Attributes Bearing on Professionalism*, 46 AM. U. L. REV. 1337 (1997).

Rosen explain, "having a lawyer [within the legal department] in charge of compliance is associated with the company's perception of heightened legal risk."[324] Lawyers, they claim, are like Herman Melville's "lightning-rod salesmen and saleswomen" putting fear into people's heads about the risks that "lightning" will strike.[325] When a lawyer (as opposed to another type of professional) is in charge of compliance "the company is more frightened of conflict with regulators and third parties."[326]

Although Rosen found that lawyers are not actually (as a practical matter) able to turn their heightened assessment of risk into effective programs and procedures that prevent risk,[327] their findings do not necessarily support the conclusion that the compliance department should not report to someone in the legal department or that the general counsel should not have compliance oversight. In other words, that lawyers *themselves* should not be the *actual professionals* to develop and put into place compliance programs at corporations does not mean that they should not be the ultimate *superintendents* of compliance.[328] Rosen find that "greater normative commitment to compliance is correlated to the perception of being watched."[329] If this is accurate, then having the general counsel ultimately oversee compliance might actually increase a corporation's normative commitment to law and law abidingness. This is because a

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324. Rosen et al., *Lawyer Cast of Mind*, *supra* note 25, at 101–02. This is consistent with research on the effects of having lawyers on the board of directors. *See, e.g.*, Charles Whitehead, Lubomir P. Litov & Simone M. Sepe, http://ssrn.com/abstract=2218855, draft of Feb. 15, 2013, *Lawyers and Fools: Lawyer-Directors in Public Corporations* at 40–43 (finding that when a lawyer is on the board there is a reduction of risk-taking by the firm that is correlated to compensation and incentive structures of the CEO).

325. Rosen et al., *supra* note 211, at 3; *cf* Krawiec, *supra* note 2, at 530–31 (discussing legal compliance professionals tendency to overstate legal risk and reviewing studies in support of that notion). For a story about a lightning rod salesman, *see* Herman Melville, The Lightening Rod Man, http://www.melville.org/lrman.htm (last visited June 13, 2013); http://www. classicshorts.com /stories/tlrm.html (last visited June 13, 2013).

326. Rosen et al., *supra* note 211, at 7.

327. They found that lawyers as compliance professionals emphasized manuals and training programs that they assessed as "merely window dressing especially for companies not committed to compliance." Rosen et al., *supra* note 211, at 7; *id.* at 181 (explaining that "where the person in charge of compliance is a lawyer, the company compliance efforts will be marked by manuals and training programs" and that "compliance structures are generally merely formal—and likely largely symbolic").

328. True, one could departmentalize and put a lawyer in charge of the new separate compliance department. However, it is not clear whether a lawyer—who is not a practicing lawyer—will place the same enhanced attention on to legal risk when not formally acting as a lawyer and working among other practicing lawyers—although they may. See, e.g., *supra* note 298. Rosen et al's research compared professional backgrounds of compliance managers, including those who were lawyers versus nonlawyers. Rosen et al., *Lawyer Cast of Mind*, *supra* note 25.

329. Rosen et al., *Lawyer Cast of Mind*, *supra* note 25, at 166; *id.* at 181.

general counsel's potentially heightened obsession with risk may help create the perception (even if not true) that the corporation cannot be shielded from the regulator's purview. And if Rosen *et al.'s* finding that lawyers follow the corporation's normative commitment to compliance is true, an enhanced commitment on the part of the corporation may mean that lawyers are less likely to look for loopholes and more likely to counsel for compliance with the spirit of the law.[330]

2. *Role of Lawyers as Legal Technicians vs. Gatekeepers*

However, the opposite may result. Separating the compliance and legal functions could entrench the fallacy that the general counsel's role is to define what the corporation "can" do from a technically legal point of view versus what it "should do" based on the spirit of the law and other considerations.

First, perceptions might change as a result of departmentalization. As discussed earlier, many general counsel interviewees claim to take their gatekeeping function very seriously and do not view their job as merely a legal exercise.[331] They view law and ethics as their core function and their role as the advisor on how a company can be a good citizen. Other studies support this contention.[332] Further, it may be true, as some of the general counsel interviewees pointed out, that general counsels are not going to simply stop playing the ethics and counselor role because they do not have formal responsibility over ethics.[333] However, perceptions of the general counsel's role might change if compliance and ethics are

330. *See supra* notes 282–283 and accompanying text.

331. *See supra* discussion at notes 182–186 and 221–223 and accompanying text. *See also* Rostain, *supra* note 19, at 473–74 ("Respondents in this study spoke with one voice about their gate-keeping functions, which they characterized in very strong terms. All were confident of their capacity to stop deals that they believed posed significant legal risks to the company.").

332. Rostain, *supra* note 19, at 473; Peter J. Gardner, *A Role for the Business Attorney in the 21st Century: Adding Value to the Client's Enterprise in the Knowledge Economy,* 7 MARQ. INTELL. PROP. L. REV. 17, 37 (explaining that business lawyers often utilize non-legal arguments to affect corporate client's behavior even if the client's intended actions are within the bounds of the law); *see* Chad R. Brown, *In-House Counsel Responsibilities in the Post-Enron Environment,* 21 ACCA DOCKET 92 (2003); (describing recent ACCA survey of 1216 in-house lawyers that found that 57 believed that "in-house counsel should play a role as important as that of the CEO, COO, or CFO in preventing financial and accounting fraud, as well as other illegal and unethical behavior"); Parker, *supra* note 1, at 342.

333. Many of the general counsel interviewees argued that maintaining the corporation's values and counseling the corporation to compliance is at the core of what they do—and will remain that way regardless of whether the compliance and legal are segmented. *See* Compliance Study Interviews. Wilkins, *Rivals, supra* note 49, at 2117 ("Lawyers can, and should, play a central role in maintaining a company's core values. Indeed, many general counsels assert that this is at the core of what they do.").

separated from the law department. As a general counsel interviewee aptly pointed out, "the risk is that you will see lawyers that are more akin or more used to basically putting the answer in terms of whether or not you can do it instead of whether or not you should." [334]

For example, chief compliance officer interviewees (even those who were formerly practicing attorneys within the legal department) often distinguished the compliance function from the legal function by explaining that compliance is about "preventing misconduct," *neutral* fact finding, acting in the interest of the company's stakeholders, and uncovering misconduct while the legal function is all about the law.[335] These former in-house lawyers claimed that the legal department involves the law and lawyers tell you what the law says and are concerned with legal liability and vigorously defending the corporation at all costs.[336] They made a demarcation between *can* and *should*. "The lawyers tell you whether you can do something, and compliance tells you whether you should."[337] The compliance officer's job is:

> . . . about doing the right thing the right way for the right reasons. In any business . . . the right way is often debatable, because, in any business, if we do X we'll make a trillion dollars but there may be a lot of legal risk. And if we do Y, we make a billion dollars but have no legal risk. . . . My job is to help people understand the potential impact of those risks . . . . My job is to make sure those conversations occur. It is not just about money but a successful business is doing the right thing.[338]

The general counsel's job, these compliance officers claim, is much more clear-cut: "The general counsel's job is . . . to advise [the company and senior managers] of the legal risks but *not* initiate the

334. Interviewee Stage 2 CCO6 at 7–8 ("And so I guess my reaction is, yeah, I could view that as a risk of splitting it out. That said, I don't know if that's something that actually happens in practice or not. I *would hope* that no matter how you cut it that the Law Department and the General Counsel still work very closely with the Compliance function, because of all the groups that we work with, they definitely have to be one of the top two or three groups that we work with on a regular basis.").

335. *See* Banks et al., *supra* note 86.

336. *See supra* note 321; *see also* SCCE Study March 2013, *supra* note 10, at 4 ("Counsel is representing the organization from a legal perspective—doing what is in the best legal interest of the organization. A compliance Officer is actually representing the integrity of the organization—what may be legal may not be ethical!") (quoting compliance professional survey respondent).

337. Pfizer Inc. Corporate Integrity Agreement, *supra* note 155 (quoting Lewis Morris of the OIG).

338. GC Interviewee Stage 2 CCO3 at 6–7. The interviewee in this quote appears to be claiming that the compliance officer advises on reputation risk as well as on what is "right" ethically which is classic legal counseling and risk counseling that general counsels typically provide.

conversation over what is the right thing to do—the general counsel's job is more black and white i.e., these are the legal risks."[339] The legal department is about whether you can do something.

> The Law Department, on the other hand, I think may be less perspective in their actions in Compliance . . . . So they basically are the ones, hey, a business person comes to them, 'Can we do this, can't we do this?' and they look at the laws and they try to make sure . . . they are the ones that are interpreting the laws and regulations for the business itself.[340]

Compliance is about ethics and whether you "should" do something:

> Legal tells you what you can do to comply with the law—what you literally need to do to comply with the law. Compliance tells you what you should do to comply with the spirit of the law—may be more than legally required. Ethics—takes it a step further tell you to ask yourself it may be legal and it may be within spirit of law but is it really in best interest of my client and my firm.[341]

All of these quotes are from legally trained professionals (who were formerly practicing attorneys) and are now leading compliance. While these role differentiating statements may be self-serving, they create the perception that the legal team is a group of super talented, super educated set of strategic individuals—completely *off* the hook for compliance, ethics, reputation, and business risk counseling—and completely *on* the hook for helping the corporation find loopholes in the law—in keeping with Rosen's findings about what lawyers do.[342]

Second, a change in perception might result in a change in expectation. While it is true (as mentioned above) that many general counsels claim that it is their job to be the gatekeepers for the corporations in which they work[343] and that inside lawyers may not view their role narrowly regardless of departmentalization, other corporate executives and managers might. And that view may, in

339. *Id.* at 7.

340. GC Interviewee Stage 2 CCO3 at 3.

341. *Id.* at 6. *See also* Roy Snell, *Just How Independent Should the CECO Be (From Legal)?*, Mar./Apr. 2011, 13 NO. 2 J. OF HEALTH CARE COMPLIANCE 25, 28 (2011) (interviewing and quoting Donna C. Boehme) ("The compliance profession falls in an entirely different dimension—it is the job of the CECO to develop, implement, and oversee a system of risk management that detects and prevents wrongdoing and supports a culture of integrity. Compliance is mostly proactive, not reactive. The legal profession never embraced this new proactive role, which as it developed required very different key competencies, skills, and mindset than usually found in a general counsel.").

342. Rosen et al., *Lawyer Cast of Mind*, *supra* note 25.

343. *See, e.g.*, Rostain, *supra* note 19, at 478 (explaining that "the GC's deployed a variety of techniques, including invoking reputational and ethical considerations to persuade their peers, proposing different, less risky ways to structure transactions, or leaving the issue to management to decide after providing a full discussion of the risks involved").

turn, impact expectations and remove some of the support for lawyers to stand up to pressure from corporate clients that want advice about what they "can" do instead of what they "should" do. Essentially, the risk is that the perception of the legal department's role affects expectations and expectations affect the ability of lawyers within the department to play that role. David Wilkins argues that we are (and should be) moving to a world of interdependent "long-term strategic partnerships"[344] between lawyers and clients.[345] Importantly, this interdependent relationship provides lawyers with the framework to say "no"—to resist pressures to pursue risky options.[346] If the departments are separate, and compliance and ethics are not part of the general counsel's purview, the level and type of influence the general counsel has in the company—an influence which general counsels have worked very hard to secure over the past thirty years[347]—may change and it may enable corporate clients to pressure lawyers to give technical answers as opposed to answers that counsel against risky or borderline unethical behavior. Indeed, lawyers, separated from compliance (and ethics), may not be expected to stand up to pressure from clients as long as the actions are within the letter of the law. Rather, they might be expected to be legal technicians and to waive their own ethical responsibilities.[348] This attitude, then, traps lawyers in an attorney-client relationship that is one of agency wherein the lawyer, as agent, owes a duty to his client (the corporation) to promote the client's interests above all else.[349] Although this may be consistent with some forms of current practice and with the agency model that has characterized the lawyer-client

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344. Wilkins, *Rivals*, *supra* note 49, at 2069–70.

345. *Id.* at 2071 (arguing that the relationship between outside counsel and clients is becoming closer to the relationship between inside counsel and clients. In other words, clients have moved both relationships to a "logic of embeddness" (as opposed to one of agency)).

346. *Id.*

347. Parker, *supra* note 1, at 341 (discussing the rise of in-house counsel in number and influence between 1970 and 1980.)

348. Indeed, in companies (like hospitals) that have legal, compliance, and risk management, one wonders if lawyers will continue to be called on to provide legal advice that includes business advice around risk—like PR risks. *See* Michele DeStefano Beardslee, *supra* note 320.

349. *See* Monroe H. Freedman, *Henry Lord Brougham, Written by Himself*, 19 GEO. J. LEGAL ETHICS 1213, 1215 (2006) ("[A]n advocate, in the discharge of his duty, knows but one person in all the world, and that person is his client. To save that client by all means and expedients, and at all hazards and costs to other persons, and, amongst them, to himself, is his first and only duty; and in performing this duty he must not regard the alarm, the torments, the destruction which he may bring upon others. Separating the duty of a patriot from that of an advocate, he must go on reckless of the consequences, though it should be his unhappy fate to involve his country in confusion.") (quoting 2 The Trial of Queen Caroline 3 (1821)) as Lord Brougham would say "by all means and expedients and at all hazards and costs to other person," even "to himself.").

relationship for decades,[350] it is inconsistent with much of the profession's history, which has—since 1820—portrayed the lawyer's role as a dual one: client advocate and public servant.[351]

Third, a change in perception and/or expectation may impact how the general counsel and in-house lawyers approach their work and view their role.[352] Currently, many general counsels claim they counsel clients on the reputational risks of decisions because of the impact negative PR can have on the business.[353] While they may continue to counsel about this business/legal concern, under the new organizational structure, it is not clear that all general counsels will choose to counsel their corporate clients on the social, ethical, and moral risks of legal decisions—especially if pressured to do otherwise.[354] There is room for role-differentiated behavior. Indeed,

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350. Wilkins, *Rivals*, *supra* note 49, at 2075 ("By characterizing the relationship between corporate lawyers and their clients as fundamentally one of agency, the standard account systematically marginalizes, and indeed delegitimizes, a lawyer's allegiance to this broader public role."); Wilkins, *Diversity Wars*, *supra* note 49, at 855–56 ("[T]he agency model of the lawyer's role assumes that all ethical obligations flow from the lawyer-agent to the client-principal.").

351. Wilkins, *Rivals*, *supra* note 49, at 2073–75 (tracing this dual obligation from 1820 to now and arguing that the agency model and market conditions today make it difficult for lawyers to play a gatekeeping role); *id.* at 2075. *See also supra* Part III.B.

352. *Id.* at 2131–32. This is a problem of shirking. In the context of law firm compliance specialists, Margaret Raymond has argued that reliance on specialists creates the risk that lawyers will feel that they do not have to own ethics principals because someone else is covering it. *See* Raymond, *supra* note 358, at 154–60. *See supra* note 334.

353. *See* Beardslee, *infra* note 363 (discussing lawyers role in counseling corporate clients on reputational risk associated with high profile legal controversies).

354. Although many general counsels claim they play a gatekeeping role (*see supra* notes 331, 332 and accompanying text), corporate scandals in the past ten to fifteen years raise some questions whether all general counsels do so and lend support for the risk that a general counsel might serve as a legal technician. *See, e.g.*, 148 Cong. Reg. S6555 (Daily ed. July 10, 2002) statement of Senator Enzi) (stating that lawyers helped draft documents that were involved in the fraudulent transactions); Robert W. Gordon, *A New Role for Lawyers:? The Corporate Counselor After Enron*, 35 CONN. L. REV. 1185, 1185–90 (2003); Susan P. Koniak, *Corporate Fraud, See Lawyers*, 26 HARV. J. L. & PUBL. POL'Y. 195, 196 (2003); Deborah A. DeMott, *The Discrete Roles of General Counsel*, 74 FORDHAM L. REV. 955, 958, 975 (2005) (detailing recent examples in which general counsels were named as defendants or plead guilty to criminal charges or securities fraud and explaining that the SEC "has recently brought an unprecedented number of enforcement actions against corporate counsel"). Just last year, the general counsel of Wal-Mart de Mexico was implicated in authorizing bribes. David Barstow, *Vast Mexico Bribery Case Hushed Up by Wal-Mart After Top-Level Struggle*, N.Y. TIMES, Apr. 21, 2012, http://www.nytimes.com/2012/04/22/business/at-wal-mart-in-mexico-a-bribe-inquiry-silenced.html?pagewanted=all&_r=1 [hereinafter Barstow, *Vast Mexico Bribery Case*]; *cf.* Langevoort, *supra* note 19, at 515–17 (exploring lawyers' role in the financial crisis and contending that "with their relative lack of financial expertise and lack of access to diffuse risk-related data—were particularly well positioned to appreciate the gradual changes taking place until it was too late. Nor was the law ever clear enough to allow them to push back effectively against the preferred interpretation of the business people even if they had become alarmed."); Donald C. Langevoort, *Where Were the Lawyers? A Behavioral Inquiry Into Lawyers' Responsibility for Clients' Fraud*, 46 VAND. L. REV. 75, 77–78 (1993) (coining the phrase "venality hypothesis"

some scholars argue that lawyers should not act as moral or ethical filters[355] and that lawyers can and should do anything within the law to secure a business advantage including bluffing.[356] Under this new organizational structure with new expectations, the general counsel and the legal team may begin to more closely identify with the business team. As Wilkins explains, when this happens, they may

> approach managing legal risks with noncompliance as a viable option.' More fundamentally, even if one concedes that both clients and firms have a mutual interest in preventing misconduct and reducing risk, there is a danger that the 'risk management' perspective that this shared interest engenders will paradoxically diminish 'a lawyer's individual responsibility for making moral choices about his role in law and society,' inducing 'a kind of moral apathy' that will ultimately 'hobble professional independence.'[357]

Creating specialized and independent compliance departments may undermine attorney accountability.[358] Attorneys reporting to a

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regarding the assumption that the reason why the legal scandal occurred was because the lawyers were greedy and corrupt, "know of their clients' misdeeds, or at best deliberately close their eyes to the evidence, simply to preserve their wealth, status and power"); *see, e.g.*, Kim, *supra* note 193; *cf.* Cassandra Burke Robertson, *Judgment, Identity, and Independence*, 42 CONN. L. REV. 1, 3 (2009) ("relying on an identity-theory explanation of lawyer behavior," and identifying two situations in which "attorneys may be particularly susceptible to such a partisan bias"). Also, as others have pointed out, "experience has shown that people who consider themselves (and are considered by others) highly moral can be led into misconduct by any of the five P's: pressure, pleasure, power, pride, or priorities—not to mention payment. Forces like these are rampant in the C-suite, where ambitious executives confront enormous economic stakes, strong pressures and incentives, and high expectations for performance, under circumstances where they have great discretion to act and the power to avoid external controls." Scott Killingsworth, Boards, CEOs, and C-Suite Compliance, Corporate Counsel, Oct. 16, 2013 at 2.

355. *See, e.g.*, Stephen Pepper, The Lawyer's Amoral Ethical Role: *A Defense, A Problem, and Some Possibilities*, 11 AM. B. FOUND. RES. J. 613, 617 (1986) (contending that lawyers should not act as moral filters. What matters is if the "conduct which the lawyer facilitates is above the floor or the intolerable and is not unlawful"); Andrew L. Kaufman, *A Commentary on Pepper*, 11 AM. B. FOUND. RES. J. 651 (1986) (arguing that rules should allow lawyers to decline to help clients with lawful conduct but "there is a great deal more scope for role-differentiated behavior" and "lawyers have to be very careful about overriding clients' wishes in the name of morality").

356. *See, e.g.*, Albert Z. Carr, *Is Business Bluffing Ethical?*, 46 HARV. BUSINESS REV. 143 (1968) ("But from time to time every businessman, like every poker player, is offered a choice between certain loss or bluffing within the legal rules of the game. If he is not resigned to losing, if he wants to rise in his company and industry, then in such a crisis he will bluff—and bluff hard.").

357. Wilkins, *Rivals*, *supra* note 49, at 2120 (internal citations and quotations omitted).

358. A similar argument has been made with respect to supervisory liability for law firms and with appointing compliance specialists in large law firms that are independent from the other lawyers in the firm. *See, e.g.*, Julie Rose O'Sullivan, *Professional Discipline for Law Firms? A Response to Professor Schneyer's Proposal*, 16 GEO. J. LEGAL ETHICS 1, 4 (2002) (claiming that law firm discipline "may actually undermine individual ethical incentives rather than furthering

general counsel that no longer also oversees compliance might "get comfortable" with providing technical legal advice that will protect the client from liability based on the letter of the law (as opposed to the spirit).[359] Adding to this is the fact that the Model Rules can be viewed as permitting (if not endorsing) lawyers that behave as Holmesian bad men and do exactly that.[360] This risk is further supported by Rosen's research that indicates lawyers can behave as followers when it comes to compliance initiatives. If the company is not committed to compliance, lawyers may see their role as "gamesters," and help the company find loopholes in the law.[361]

Lastly, if you have a broad view of the role of lawyers, if you believe as other scholars[362] and many general counsels do,[363] that the

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attorney accountability"); *see also* ROBERT A. CREAMER, COMMENTS CONCERNING DRAFT MODEL RULES 5.1 AND 5.3 (A.B.A. COMMISSION ON EVALUATION OF THE RULES OF PROFESSIONAL CONDUCT 2000), http://www.abanet.org/cpr/creamer10.html [hereinafter Creamer, Comments] (stating that "[a]ny shift from the individual responsibility of lawyers to the collective responsibility of the firm" will undermine the deterrent value of disciplinary sanctions); *see* Raymond, *supra* note 43 at 154 ("Telling pressured and overwhelmed lawyers that this area is, in effect, way too complex for them to master may cause them to lack ownership of ethics principles."); *but see* Chambliss, *Nirvana*, *supra* note 110, at 138–39 (arguing the opposite).

359. This is often a complaint made against outside attorneys. *See* Simon, *The Kaye Scholar Affair*, *supra* note 197, at 246–51, 264–68. *See also* Langevoort, *supra* note 19, at 495–96 (discussing how lawyers try to "get comfortable" with client goals and contending that "the process of "getting comfortable" may too readily become a process of collective rationalization" that undermines lawyer objectivity); *id.* at 505 ("My hypothesis about in-house counsel is that an above-average tolerance for legal risk and a "flexible" cognitive style in evaluating such risk are survival traits in settings where corporate strategy and its surrounding culture are strongly attuned to competitive success."); *id.* at 513–14; *see generally* BAZERMAN & TENBRUNSEL, *supra* note 127 (discussing biased professional judgment in business settings).

360. *See* Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 459 (1897) ("If you want to know the law and nothing else, you must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict, not as a good one, who finds his reasons for conduct, whether inside the law or outside of it, in the vaguer sanctions of conscience."); Pearce and Wald, *supra* note 186, at 528 (pointing out that "the Rules' embrace [sic] the understanding that lawyers and clients are autonomous actors has undermined regulatory efforts" and that "this perspective blocks the development of a culture that supports compliance.").

361. *See supra* notes 281–283.

362. Wilkins, *Rivals*, *supra* note 49, at 2112 ("In addition to being zealous advocates for the interests of their clients, lawyers are also supposed to play a broader gatekeeping role in which they both counsel their clients to conform their conduct to legal standards and refuse to cooperate—and in extreme cases, even blow the whistle—when the client seeks to engage in conduct that undermines these standards."); Wilkins, *supra* at 680 ("Elite lawyers never conceived of themselves . . . as 'deferential servants' who merely carry out the client's bidding. Instead, these early lawyers aspired to be wise counselors, or 'lawyer-statesmen' . . . who played a key role in shaping their clients goals and in mediating between these private ends and public purposes of the legal framework."). This view is also consistent with the view held by some scholars that "lawyers not only can but also should counsel clients on non-legal issues, particularly moral concerns." Larry O'Gantt, II, *More Than Lawyers: The Legal and Ethical Implications of Counseling Clients on Nonlegal Considerations*, 18 GEO. J. LEGAL ETHICS 365,

general counsel should have gatekeeping responsibilities and should play the role of counselor in charge of corporate culture and ethics and the corporate conscience of the company,[364] then this move toward separation presents an ideological problem as well.[365] To be sure, there has been debate over whether Anthony Kronman's "lawyer-statesman" ideal[366] should be put to rest. However, there has been a growing emphasis on lawyers' obligations, the role of the lawyer in society, and the need for a view that re-embraces the lawyer's dual obligations.[367] Further, there has been increased

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365 (2005). *See also* Gregory Sisk & Pamela J. Abbate, *The Dynamic Attorney-Client Privilege* 23 GEO. J. LEGAL ETHICS 201, 237 (2010) ("[A] lawyer who fails to engage in a moral discussion with the client, at least on matters of significance with obvious moral implications, simply is not doing his or her job."). Evidently, Section 307 of the Sarbanes-Oxley Act of 2002 targets inside counsel for just this reason. Kim, *supra* note 193, at 986 (contending that although SEC believed that "inside counsel are in a superior position to interdict corporate fraud," inside counsel have failed to prove this true, and the SEC and the *Model Rules of Professional Conduct* have "set [general counsels] up for failure"); *see also* COFFEE, *supra* note 18 at 195 (claiming that there are many reasons to doubt that that inside counsel can or will "specialize in preventive law," despite their unique potential to do so); ROBERT L. NELSON, PARTNERS WITH POWER: SOCIAL TRANSFORMATIONS OF THE LARGE LAW FIRM 247, 258 (1988) (contending that because corporate attorneys identify with their clients, they may not be able to behave as gatekeepers); Nelson & Nielsen, *supra* note, 183, at 477 (concluding based on qualitative research that in-house lawyers "were willing to 'discount . . . their gatekeeping function in corporate affairs' in order to be seen as part of the company, rather than as obstacles to getting things done."); *see supra* note 249 (discussing research that suggests the opposite).

363. Heineman, *supra* note 185, at 60–62. There is other support for this contention. For example, in a 2003 survey by the American Corporate Counsel Association of 1216 corporate counsel, seventy-eight percent of the respondents felt in-house attorneys should report misconduct when they learn of it. Chad R. Brown, *In-House Counsel Responsibilities in the Post-Enron Environment*, 21 ACCA DOCKET 92, 97 (2003); *see* Michele DeStefano Beardslee, *Advocacy in the Court of Public Opinion Installment I, Broadening the Role of Corporate Attorneys*, 22 GEO. J. LEGAL ETHICS 1259, 1168 (2009) (claiming that research indicates that "many corporate attorneys want to play a gatekeeping role or, at least, want to counsel clients to behave socially responsibly"); Heineman, *supra* note 185, at 60–62 (claiming that GCs want to show "a deep concern about both the private good and the public interest—and a deep concern about building durable institutions which achieve their aims in a fair and honest way even under stress") (quoting Kronman); Rostain, *supra* note 19, at 465–90 (claiming that there is empirical support for the contention that general counsels, in part because of the new regulatory environment, are beginning to play a larger gatekeeping role than before).

364. Heineman, *supra* note 19, at 2 ("[I]t should be the role of the GC not only to address the question of 'what is technically legal,' but also to raise and help analyze the question of 'what is right.'"); *id.* ("It is ludicrous to suggest, as some do, that the GC only worries about what is "legal" and the chief compliance officer worries about what is "right." The "what-is-right" set of issues is at the center of the role of the modern, broad-gauged general counsel as wise counselor and leader.").

365. Indeed, many of the interviewees saw these distinctions in reverse—claiming that it is the general counsel (as opposed to the chief compliance officer) that is in charge of the ethical culture of the company and that CCOs can sometimes just be "traffic cops." Interviewee Stage 2 CCO5 at 24 ("I don't think it's hard for me. I mean, I think I try to explain to people that Compliance is still black-and-white and what are the rules.").

366. *See* KRONMAN, *supra* note 182, at 12; *see also* Ben W. Heineman, Jr., *supra* note 46.

367. Wilkins, *Rivals*, *supra* note 49, at 2076.

emphasis in common law, legal practice, and other regulations to hold lawyers more accountable to more constituents for their behavior and for the social consequences of their corporate clients' conduct.[368] Departmentalization may work against these movements.

V. HYPOTHESIS, OTHER CONSIDERATIONS, AND A PRELIMINARY PROPOSAL

Based on the analysis in Part IV, this Part provides a hypothesis and a proposal for future focus and change.

A. HYPOTHESIS

Departmentalizing compliance from legal so as to remove general counsel oversight of compliance may not necessarily be in the public's best interest. To the contrary, the analysis leads to the hypothesis that departmentalization poses consequences that might subvert its objectives.

The current unofficial governmental preference for stand-alone compliance officers and departments prizes independence and traditional notions of control over interdependency, embeddedness,[369] and collaboration. Although autonomy and independence are important for reporting compliance transgressions, without power and influence, the chief compliance officer's ability to monitor and deter noncompliance may diminish. Departmentalization may ostracize the compliance officer from those that have the sway with the C-suite and it may create barriers that impede communication and collaboration with people across the organization. Specifically, for some corporations, a divided reporting structure could create turf wars, potential inefficiencies, and communication gaps within the corporation. Also, departmentalization does little to ensure that the right type of professional is leading compliance and that it is staffed with the right level of expertise. Further, departmentalization may strengthen the argument that the attorney-client privilege should apply to communications with lawyers around compliance issues and, therefore, lead to less transparency into corporate behavior and

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368. Milton C. Regan Jr., *Professional Responsibility and the Corporate Lawyer*, 13 GEO. J. LEGAL ETHICS 197, 204–06 (2000). For an argument that legal scholars tell their clients what they want to hear and help law firms develop justifications for conduct that is close to legal malpractice, *see* William H. Simon, *The Market for Bad Legal Advice: Academic Professional Responsibility Consulting as an Example*, 60 STAN. L. REV. 1555, 1556–58 (2008); Wilkins, *Rivals*, *supra* note 49, at n.187 (explaining that, [Simon's] contentions that academic ethics advisers are providing bad advice asside, his claim that corporate clients desire lawyers' opinions that support corporate decisions, arguably, has merit).

369. Wilkins coined this term. Wilkins, *Rivals*, *supra* note 49.

decrease the ability of the government to prosecute criminal noncompliance. Lastly, departmentalization may work against the creation of a culture of compliance and normative commitment to compliance in two ways. First, having ethics and compliance outside the legal department's purview risks a role division that places the general counsel and/or the legal department in the role of legal technician or worse the role of gamester. In that world, lawyers could be expected to help the corporation comply with the letter of the law at the sake of the spirit of it. Second, although governmental officials have claimed that they will assess whether a company has a culture of compliance when determining liability for noncompliance,[370] they place value on structural manifestations of compliance like adoption of codes of conduct, revisions to mission statements, and enactment of training programs.[371] However, there is little empirical evidence that these trappings are effective at deterring prohibited conduct without more[372] and experts claim they may actually be the "weakest

370. William H. Donaldson, Chairman, SEC, Address at Directors College at Stanford University Law School (June 20, 2004), http://www.sec.gov/news/speech/spch062004whd.htm ("What's really needed is a change in mindset—a company-wide culture that fosters ethical behavior and decision-making. Creating that culture means doing more than installing competent legal and accounting staff, and doing more than giving them responses and up-to-date technology. It means instilling an ethic—a company-wide commitment to do the right thing, this time and every time—so much so that it becomes the core of what I call the essential 'DNA' of the company."); *see* RULE 38A-1 LEGAL ALERT, *supra* note 36, at 8 ("SEC officials have stated that a culture of compliance begins with senior management and that the SEC staff will inquire about the role of the board, senior management and other key executives in setting compliance strategy and holding supervisors responsible for compliance. Does senior management adhere to a fundamental philosophy of a fiduciary in serving the needs of investors first? Is the enterprise's compliance policy in writing, communicated to employees and emphasized by the CEO?"); *see also* Richards, *Instilling*, *supra* note 17, at 4 ("Simply put, this means instilling in every employee an obligation to do what's right—even if there is no clear legal restriction or regulatory guidance."); Richards, *New Compliance Rule*, *supra* note 17.

371. *See supra* discussion in Part III. *See* Legal Alert, *supra* note 36 (quoting Rule 38A); *see generally* Krawiec, *supra* note 2, at 494–511; Richards, *Instilling*, *supra* note 17 at 6 (noting that the most frequent finding of SEC's inspection staff was inadequate written policies and procedures).

372. *See supra* notes, 43, 53, and 58 and accompanying text; Krawiec, *supra* note 2, at 511–22 (arguing more broadly that the negotiated governance model used to regulate compliance represents opportunities for strategic behavior on the part of organizational defendants and legal compliance professionals.); *cf.* Gary R. Weaver et al., *Corporate Ethics Practices in the Mid-1990's: An Empirical Study of the Fortune 1000*, 18(3) J. BUS. ETHICS 283, 283 (1999) (finding that "the vast majority of firms have committed to the lower cost, possibly more symbolic side of ethics activity: the promulgation of ethics policies and codes."); BAZERMAN & TENBRUNSEL, *supra* note 127, at 122; *cf.* Parker & Gilad, *supra* note 17, at 23–29 (concluding that it is difficult to empirically evaluate formal compliance systems given the complexity of corporate behavior and that culture is "largely invisible in quantitative survey research"); *id.* at 13 (supporting the idea that regulatory initiatives cannot create a corporate culture simply by requiring certain compliance structures because the way those structures are implemented and understood in practice is variable); *but see generally* Parker & Nielsen, *supra* note 212 (finding that the implementation of six different formal compliance structures is associated with better

link in an organization's ethical infrastructure."[373] Departmentalization may be just another one of those trappings.[374] Thus, there is a risk that corporations will departmentalize and adopt these common structural exemplifications of a robust compliance program as "best practice," believing that real change will result.

The problem with this is that studies have shown that the informal norms imposed by other employees are superior to the formal controls that managers implement.[375] Part of the reason for this is that formal controls are completely unconnected to the way employees interact[376] and are decoupled from norms and ethics.[377] The government's current preference for stand-alone compliance departments does not consider and account for: 1) networks (the importance of internal networks to effective compliance); 2) how ethics intersects with compliance and law; and 3) how people are motivated.[378] The next section discusses these topics.

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compliance practice but commitment and oversight by management and organizational resources are just as important).

373. BAZERMAN & TENBRUNSEL, *supra* note 128, at 118; *id.* at 122 (explaining that "the informal norms are difficult to overtly identify. Rather, they are embedded in the stories employees tell, the euphemisms they use, the socialization methods they encounter, and the informal enforcement of norms."). As Robert E. Rosen points out, if you "[t]reat the corporation as a bureaucracy" then "one gets meaningless bureaucratic responses that will not alter the behavior of redesigned corporations." Rosen, Risk Management, *supra* note 20, at 1168–69.

374. *See supra* analysis Part IV. Note: this is not to suggest that compliance officers should not also report to the board of directors. Indeed, having a dotted line and access to the board and a direct report to the general counsel may be a great alternative to departmentalization for corporations. *See supra* note 43.

375. BAZERMAN & TENBRUNSEL, *supra* note 128, at 118; *id.* at 122; *id.* at 18.

376. *Cf.* Parker & Gilad, *supra* note 17, at 9 (pointing out that "a compliance system does not stand alone sending unambiguous messages and instructions. Second are the perceptions, motivations and strategies of individuals within the organization, which may involve avoidance, resistance, ritualism and creative compliance in addition to commitment and capitulation."); *id.* at 11–13.

377. *Cf.* BAZERMAN & TENBRUNSEL, *supra* note 128, at 19.

378. Evidently, "little empirical attention has been devoted to examining how people actually *do* behave and how their ethical behavior can be improved—knowledge that is needed to understand and improve not just how philosophers behave, but also how the ethical and economic crises of the past decade emerged." BAZERMAN & TENBRUNSEL, *supra* note 128, at 28. Other scholars in the field of compliance have argued that it important to understand the inner workings and networks of a corporation as well as the motivations values and perceptions of compliance professionals and the teams and individuals that make up the organization. *See generally* Parker & Gilad, *supra* note 17; *see* Parker, *supra* note 25 at 203–05 (arguing that formal structures will not change behavior unless they are based on an understanding of motivations and connected to employees values). Ben W. Heineman, Jr., argues that the CEO is the only person within the corporation that has the power and ability to create a culture of compliance and that only the CEO can combine high performance with high integrity (describing the principals and practices that CEOs should adopt to do so). Heineman, High Performance, *supra* note 4; Heineman, *Only the Right CEO*, *supra* note 4, at 2.

B. OTHER CONSIDERATIONS: CONNECTIVITY, ETHICS, AND MOTIVATION

1. *Connectivity*

The importance and utility of formal, prescribed roles in corporations has diminished. According to sociologists, this is because of globalization, "a rise in knowledge-intensive work"[379] that "has become more project-specific, flexible, and short-term, "and "managerial initiative[s] such as delayering, reengineering, and team-based designs."[380] Thus, the way that employees interact and the groups they interact with do not match static organization or traditional communication flow diagrams.[381] Instead, "social networks" (defined by Rob Cross and Andrew Parker as "those crossing functions in a core process or integrating mergers or alliances") are the more relevant indicator of organization and communication flow within institutions.[382] And they have a dynamic influence on an organizations' performance and its ability to execute strategy, react to issues, and to change.[383] The internal dynamics of a corporation can create stopgaps and "moral mazes."[384] Thus, an emphasis on the formal organizational structure of a corporation to gauge the effectiveness of its compliance function may be misplaced.[385] Instead, there is a need for a more inward look at the webs of connection that cannot be seen on an organization chart. There is a need to identify the social networks that exist within a

379. *See* ROB CROSS & ANDREW PARKER, THE HIDDEN POWER OF SOCIAL NETWORKS: UNDERSTANDING HOW WORK REALLY GETS DONE IN ORGANIZATIONS, HARV. BUS. SCHOOL PRESS at vii (2004).

380. *Id.* at 133; Rosen, *supra* note 20, at 1166–67 (describing Enron as an example of new corporate structure "in which self managing teams initiate and design projects").

381. CROSS & PARKER, *supra* note 378, at 133; Rosen, *supra* note 20, at 1163–64.

382. CROSS & PARKER, *supra* note 378, at vii.

383. *Cf. id.* at 133 ("Managers have paid little attention to the more dynamic characteristics of networks and the ways that dynamic qualities of networks affect organizational flexibility and change."); *id.* at vii. ("These seemingly invisible webs also have become central to performance and execution of strategy. Research shows that appropriate connectivity in well-managed networks within organizations can have a substantial impact on performance, learning and innovation."); W. Tsai and S. Ghoshal, *Social Capital and Value Creation: The role of Intrafirm Networks*, 41 ACADEMY OF MANAGEMENT JOURNAL 464, 474 (1998).

384. *See* CROSS & PARKER, *supra* note 378, at 133; Robert Jackall, *Moral Mazes: Bureaucracy and Managerial Work,* HARV. BUS. REV. 118–30 (Sept.–Oct. 1983); Hasnas, *supra* note 5, at 520 (making a similar point); Kogut & Zander, *supra* note 267, at 387 ("The knowledge displayed in an organizational chart, as in any blueprint, is limited to providing information on personnel and formal authority. The know-how is the understanding of how to organize a firm along these formal (and informal) lines.").

385. *Cf.* CROSS & PARKER, *supra* note 378, at vii, viii, 10 (maintaining that organizational charts do not "adequately represent how work gets divvied or done").

corporation, and importantly that do not exist, despite the line or dotted line on the chart. So much depends on the relationships between the individual executives and the teams. In keeping with that, many interviewees believed that their compliance department was effective because there was a special relationship between the general counsel and compliance officer.[386]

It is not, however, simply an issue of the relationship between the chief executives or even the right attitude of chief executives. A common theory (and one that many interviewees purported) is that the right tone at the top is essential to establishing a culture of compliance.[387] While that may be true, in keeping with the notion that social networks are integral to compliance culture at an organization, as one deputy general counsel who was also the chief compliance and ethics officer explained, it may be the tone set at the *middle*—at the intersection of social networks—matters just as much:

> I don't worry about the tone at the top; I worry about the tone in the middle, and that's what I focus on. So I tell people, "We can have great tone at the top; but the people in the warehouse, they look at their Supervisor, they look at their Manager. So if their Manager is having sex with the secretary, they don't believe anything about the Ethics Program." You know what I mean? . . . But the secretary can come in late, and they can't come in late. They don't care what we tell 'em about ethics. That's what ethics means to them, because if they are going to get fired because they are late, but the secretary gets to stroll in late because she's sleeping with the Supervisor, that's what ethics mean to them.[388]

Essentially, a culture of compliance has to be integrated from the top down. The adoption of compliance systems and structures

386. Perhaps this special relationship exists because it is not uncommon that the chief compliance officer was formally a deputy general counsel. When a close relationship exists, the threat of turf wars may decrease. *See supra* note 254 and accompanying text.

387. Gilad, *supra* note 17, at 15 (making similar point and pointing to empirical studies that suggest that "management commitment is important to the success of corporate compliance systems.); *cf.* HEINEMAN, HIGH PERFORMANCE WITH HIGH INTEGRITY, *supra* note 4, at 5 (contending that only the CEO can create a culture of integrity but to do so CEOs must "move beyond 'tone at the top' platitudes" and instead utilize "powerful leadership that voices the vision and the values" and "effective management that builds the integrity principles and practices into business operations"); *see also* MICHAEL VOLKOV, COMPLIANCE IN THE C-SUITE 6 (2013), *available at* http://www.compliancestrategists.org/wp-content/uploads/2012/09/ Volkov-WP-Final-Draft-with-Pre-Pub-Banner-May-2013.pdf; Killingsworth, *supra* note 354, at 2–3 (contending that "the board must do more than hire a CEO of apparent high integrity and get out of the way" and recommending that the board take a more involved role in compliance).

388. Interviewee Stage 2 CCO5 at 26–27.

(especially at the top) does not ensure that compliance and ethics will be internalized.[389]

2. *Ethics*

Despite the efforts by corporations to enhance internal compliance and adherence to ethics, it is not clear that the programs developed by corporations have done so or are designed to effectively do so.[390] According to leading sociologists and legal scholars, one of the reasons for this failure is because the compliance initiatives do not account for the reality that employees do not necessarily recognize an ethical dilemma—as an ethical dilemma—when it is presented to them,[391] and many ethical violations are unintentional[392] and have nothing to do with integrity but rather result from "blind spots."[393]

Research shows that these "blind spots" can stem from functional boundaries[394] within an organization that create segmented decisions across departments.[395] "As a result, the typical ethical dilemma tends to be viewed as an engineering, marketing, or financial problem even when the ethical relevance is obvious to other groups."[396] An often-cited example of this is the decision by NASA and Morton Thiokol engineers to launch the Challenger despite evidence that the Challenger had close to a one hundred percent chance of failure.[397] Because the decision was classified as a "management decision,"[398] the group recommended launching the Challenger. Another oft repeated example is the story of the Ford Pinto. According to researchers, the decision to bring the Pinto to market despite evidence that it may kill people was viewed as a "business decision," "based on a cost-benefit analysis that weighed the minimal cost of repairing the flaw (about $11 per vehicle at the time) against the cost of paying off potential lawsuits following accidents."[399] Ergo, how people classify a decision affects the decision.[400] And a contributing factor to that classification is the

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389. Gilad, *supra* note 17, at 22–23; Parker, *supra* note 25, at 208–12.

390. BAZERMAN & TENBRUNSEL, *supra* note 127, at 28 (citing study that found "little support for the notion that traditional ethics training creates more ethical citizens").

391. *Id.* at 4, 30.

392. *Id.* at 19.

393. *Id.* at 21.

394. *Id.* at 16; *id.* at 30.

395. *Id.* at 16.

396. *Id.*

397. *Id.* at 15–16 (explaining that this group failed to look outside the data in the room and if they had it would have been clear).

398. *Id.* at 16.

399. *Id.* at 70.

400. *Id.* at 30–31.

hierarchies within organizations that protect various groups and people from internalizing their actions.[401] People have a tendency to fail to recognize another's behavior as unethical when doing so would in some way disadvantage the observer.[402] Further, people generally feel less concerned about unethical behavior that is indirect as opposed to direct.[403] This is extremely problematic in a large organization where decisions can be segmented by departments and it is hard to get a bird's eye view or see the domino effect.

Another contributor is ethical fading. People become desensitized to ethical transgressions as they are more exposed to them, or do them.[404] The notions of the "slippery slope" and "the devil is in the details" appear to be true. For example, according to research studies on lawyers reporting billable hours, some law firms have required that their lawyers provide more detailed reports of their time.[405] Instead of having the intended benefit of increased transparency and ethical behavior, such initiatives have the opposite effect.[406] This is because, in order to provide more detailed reporting of hours, the law firms have created "hundreds of codes for specific activities that a legal professional might undertake for a client."[407] Because lawyers have to decide whether a specific act falls under one of a hundred listed activities that they might undertake (in addition to doing so in six-minute intervals), they start to have to guess. Once they start to make small guesses, guessing becomes acceptable and eventually turns into larger guesses; "and a system designed to promote ethical behavior backfires."[408]

A mandate to separate compliance from legal does little to highlight the importance of ethical decision-making or to ensure that compliance professionals understand and attempt to account for ethics in a way that leads to more ethical behavior by employees.

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401. BAZERMAN & TENBRUNSEL, *supra* note 127, at 75.

402. *Id.* at 81. (explaining that people also have a tendency to re-create history and see their actions as more ethical than they were); *see id.* at 62; *id.* at 73 (talking about people's tendency to be "revisionist historians").

403. *Id.* at 89–93 (labeling it "indirect blindness").

404. *Id.* at 76; *see generally* Kirkland, *Self-Deception and the Pursuit of Ethical Practice: Challenges Faced by Large Law Firm General Counsel*, 9 U. ST. THOMAS L. J. 593, 604 (2011).

405. BAZERMAN & TENBRUNSEL, *supra* note 128, at 108; Killingsworth, *supra* note 354, at 2 ("Factors such as conflicts of interest, overconfidence, in-group loyalty, conformity pressures, motivated blindness, and attentional blindness—plus the disinhibiting effect of power—cloud our judgment, make the first small step of misconduct easy to take and easier still to rationalize, and lubricate the slippery slope. . . the key to understanding misconduct is not in its explosive endings but in its quiet beginnings. Once context bends character on a small scale, escalation may turn out to be easy if not inevitable.").

406. *Id.*

407. *Id.*

408. *Id.*

3. Motivation

Standards set by the U.S. government and other organizations have called for corporations to adopt "appropriate incentives" to comply with the compliance and ethics program.[409] However, the question is, what incentives motivate compliance?

According to Daniel H. Pink,[410] human beings are not entirely rational[411] and although people are motivated by external incentives,[412] "intrinsic motivation is of great importance."[413] Further, studies show that economic incentives work to motivate people to perform routine tasks. This is not necessarily the case when it comes to more complex work or heuristic decision making that involves using judgment, ethics, and creativity.[414] Indeed, according to Pink, monetary incentives can take the good out of doing good.[415]

It is true that lots of compliance processes are routine, check-the-box tasks. Therefore, it may be possible to motivate employees to comply with these processes with monetary incentives or incentives around promotion reviews.[416] However, it is the decisions that come

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409. U. S. SENTENCING COMM., GUIDELINES MANUAL § 8B2.1(a) at 496 (2012).

410. DANIEL H. PINK, DRIVE: THE SURPRISING TRUTH ABOUT WHAT MOTIVATES US (reprt. ed. 2011).

411. *Id.* at 26.

412. Peter Drucker, *Don't Change Corporate Culture—Use It!*, WALL ST. J., Mar. 28, 1991, at A14 ("Changing habits and behavior requires changing expectations and rewards. People in organizations . . . tend to act in response to being recognized and rewards—everything else is preaching."); Joseph Murphy, *Using Incentives in Your Compliance and Ethics Program* 26 (SOC'Y OF CORPORATE COMPLIANCE AND ETHICS (2011), *available at* http://www.corporatecompliance.org/Portals/1/PDF/Resources/IncentivesCEProgram-Murphy.pdf ("People tend to do what gets rewarded.").

413. BRUNO S. FREY, NOT JUST FOR THE MONEY: AN ECONOMIC THEORY OF PERSONAL MOTIVATION 118–19 (reprt. ed. 1997) ("Intrinsic motivation is of great importance for all economic activities. It is inconceivable that people are motivated solely or even mainly by external incentives."). PINK, *supra* note 409, at 30 (making the same point).

414. PINK, *supra* note 409, at 30. ("[E]xternal rewards and punishments—both carrots and sticks—can work nicely for algorithmic tasks. But they can be devastating for heuristic ones. Those sorts of challenges—solving novel problems or creating something the world didn't know it was missing—depend heavily on Harlow's third drive.") (citing researcher Teresa Amabile and explaining that "Amabile calls it the intrinsic motivation principle of creativity, which holds in part: "intrinsic motivation is conducive to creativity; controlling extrinsic motivation is detrimental to creativity. In other words, the central tenets of Motivation 2.0 may actually impair performance of the heuristic, right-brain work on which modern economies depend."); BAZERMAN & TENBRUNSEL, *supra* note 128, at 104.

415. PINK, *supra* note 410, at 48 (explaining research study where offering money to people to give blood decreased by half the number of people willing to give blood).

416. Murphy, *supra* note 412, at 28 (outlining the common arguments against incentives and recommending the use of incentives including incentives tied to performance evaluations and promotions and recommending using rewards and recognition like letters from the CEO, articles in a newspaper recognizing good behavior, competitions and nominations, certificates, lunches, time-off, and cash).

close to the line, that involve ethics or morals and personal preferences, that affect the culture of the corporation and that aren't as easily motivated by economics. In these situations, it is not clear that "if-then" rewards will work because according to leaders in the field of motivation, "if-then" rewards "neglect[] the ingredients of genuine motivation—autonomy, mastery, and purpose."[417]

Moreover, compliance goals that are tied to sales or quarterly returns are set by others as opposed to by the employee themselves. Although having the goal in and of itself can be beneficial in the sense that it sets expectations and provides a target, there is the risk that the goal can act like horse blinders—narrowing off bigger picture and future forward thinking.[418] Thus, as Pink points out, such goals "can restrict our view of the broader dimensions of our behavior."[419] Often this point is made to support the idea that people can seek to meet business targets and, in the process, fail to consider the ethical components of their decisions.[420] Thus, the risk is that an economic incentive can induce people to choose the quicker road over the high road.[421]

Research has also demonstrated that implementing a compliance program with too much emphasis on penalties can increase unethical or undesirable behavior.[422] For example, studies on parents picking up their children late from day-care have shown that when these facilities implement fines for being late, parents are more likely to be late. This is because once there is a fine in place, the parents are less likely to view the decision of whether to pick up their child on time or not as an ethical one. Instead, it is a practical choice, a cost-benefit scenario, with no need to search to figure out "what is the right thing to do."[423] As Paine points out, the compliance approach based on

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417. PINK, *supra* note 410, at 49.

418. *Id.* at 51 (contending that business school professors suggest that goals "should come with their own warning label: Goals may cause systematic problems for organizations due to narrowed focus, unethical behavior, increased risk taking, decreased cooperation, and decreased intrinsic motivation. Use care when applying goals in your organization.").

419. *Id.* at 50; BAZERMAN & TENBRUNSEL, *supra* note 128, at 106.

420. Paine, *supra* note 5, at 107 (describing how this happened at Sears); Murphy, *supra* note 412, at 26–27; Murphy, *supra* note 41, at 26–27 (arguing that the stronger the incentives, the stronger the controls need to be especially when the people setting the rewards are the people that will benefit from them).

421. PINK, *supra* note 410, at 51.

422. BAZERMAN & TENBRUNSEL, *supra* note 128, at 109. Research has also shown that "[s]trict enforcement of the terms of a contract has the unintended consequence of emphasizing the minimum amount of work required for an employee to satisfy his or her obligations and avoid punishment." David F. Larcker & Brian Tayan, *Trust: The Unwritten Contract in Corporate Governance*, *in* STANFORD CLOSER LOOK SERIES 1 (2013), *available at* http://www.gsb.stanford.edu/sites/default/files/documents/34_Trust.pdf (explaining that strict enforcement of contracts can "reduce, rather than increase, productive effort").

423. BAZERMAN & TENBRUNSEL, *supra* note 127, at 111–12 (giving other examples and

deterrence and the threat of sanctions[424] envisions people as rational maximizers of self-interest, responsive to the personal costs and benefits of their choices, yet indifferent to the moral legitimacy of those choices.[425]

People may rush to check-the-box and conform to compliance requirements. However, they may do so without absorbing the rationale and reasons behind the rule or considering the moral implications. This is a common complaint against command-and-control approaches to regulation and compliance.[426] When compliance rules and consequences exist, it takes the people off the hook to determine ethical behavior and it may even undermine intrinsic motivation.[427] Unsurprisingly, studies have shown that corporations that take a command-and-control approach—as opposed to a more comprehensive approach based on integrity, ethics or self-regulation—are less effective at enhancing compliance.[428] And importantly, there is not a "command" or "rule" for every choice—many decisions fall into a gray area—where the rules are ambiguous. And it is in the gray area where the role of culture is most important.[429] And it is the gray area that keeps compliance officers up at night—those situations where employees are left to navigate, interpret, and make choices when options A, B, and C, are not available.[430]

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maintaining that this is true even when the sanctioning system was stronger and had more teeth).

424. Hasnas, *supra* note 5, at 516 (describing the "command-and-control" approach which attempts to "control employee behavior through intense monitoring and the threat of punishment for misbehavior"); *see infra* notes 436–438 and accompanying text.

425. Paine, *supra* note 5, at 110.

426. *See infra* notes 436–438 and accompanying text.

427. PINK, *supra* note 409, at 56 ("Rewards . . . can limit the breadth of our thinking. But extrinsic motivators—especially tangible, "if-then" ones—can also reduce the depth of our thinking. They can focus our sights on only what's immediately before us rather than what's off in the distance."); *see also* Lisa D. Ordonez, Maurice E. Schweitzer, Adam D. Galinsky, and Max H. Bazerman, *Goals Gone Wild: The Systematic Side Effects of Over-Prescribing Goal Setting* 7 (Harvard Bus. Sch., Working Paper No. 09-083, 2009) ("The very presence of goals may lead employees to focus myopically on short-term gains and to lose sight of the potential devastating long-term effects on the organization."); Hasnas, *supra* note 5, at 517.

428. Hasnas, *supra* note 5, at 516–17. Providing a recommendation about which type of approach corporations should take towards compliance (whether it is a command-and-control, integrity-based, or self-regulation approach) is outside the scope of this Article.

429. Edelman & Suchman, *supra* note 43, at 501–02; ("If all legal doctrine were substantive and unequivocal and if all legal implementation were coercive and undeviating, then one could imagine a simple feedback loop, in which organizations would adjust their behaviors exclusively in response to existing laws . . . . In the [institutional] account, however, the plot-line is much messier than this."); *see also* Chambliss, *Nirvana*, *supra* note 110, at 138–39 (making similar point).

430. Paine, *supra* note 5, at 107–08 (describing Sears problematic automotive policies and explaining that "[m]anagement] failed to clarify the line between unnecessary service and

If neither sticks nor carrots are the solution, how can corporations motivate and/or convince their employees to *want* to comply—as opposed to incent them to simply comply. How can corporations get at the intrinsic motivation? Research has shown that when the organization and employees values are in sync and when there is trust, employees view other employees' transgressions as a personal affront—an offense against themselves.[431] In that situation, instead of checks and controls designed to monitor and detect transgressions, employees self-monitor.[432] As Pink explains, "When the reward is the activity itself—deepening learning, delighting customers, doing one's best—there are no shortcuts. The only route to the destination is the high road. In some sense, it is impossible to act unethically because the disadvantaged person is not a competitor, but yourself."[433]

C. PRELIMINARY PROPOSAL: CONCENTRATE ON INTERNAL NORMS

The purpose of this Article is narrow—to analyze whether corporations should preemptively comply with the government's unofficial stance on compliance department structure. However, the article would not be complete without at least some thoughts on what the government and corporations should do in lieu of preemptive reorganization.

The government's unofficial preference towards stand-alone compliance departments that are completely independent from the legal department does not account for the impact that internal networks, ethics, and individual intrinsic motivation have on a corporation's ability to effectuate an effective compliance program.[434] Rather, it is a command-and-control approach that emphasizes the importance of structural and formal exemplifications of a compliance program without regard for the individual workings of the corporation and participation by the corporate executives and

legitimate preventative maintenance coupled with consumer ignorance, left employees to chart their own courses through a vast gray area, subject to a wide range of interpretations").

431. Hasnas, *supra* note 5, at 517. Larcker & Tayan, *supra* note 422, at 2 (contenting that "a corporate governance system based on trust might be more cost-effective than one built on elaborate controls and procedures").

432. Larcker & Tayan, *supra* note 422, at 2.

433. PINK, *supra* note 410, at 51; Paine, *supra* note 5, at 112 (indicating that personal commitment is key to ethical conduct).

434. It may be true that the CEO has ultimate power and influence to create a culture of integrity and that such a task is not a staff function. *See supra* notes 378 and 387. However, even if the corporation has the "right" CEO for the task, the internal networks must be addressed in order to effectuate a culture of integrity.

employees in the decision-making.[435] Such emphasis (in addition to potentially creating negative consequences and a risk of false complacency as discussed above) may cause corporations to follow the government's lead and take a more command-and-control based approach when implementing new compliance programs—which has been found to be less effective than an integrity-based or self-regulation approach that involve considerations around ethics, values, and individual motivation.[436] Essentially, such a specific (and reactive) requirement (as opposed to a more principles-based approach) is not flexible[437] and does not require that the parties understand the purpose or take responsibility for (or partake in) interpreting and achieving the desired goal of departmentalization.[438]

Therefore, instead of emphasizing the importance of structural changes and deciding *ex ante* that departmentalization is the remedy for corporate noncompliance and government leniency, corporations should look inward at the actual decision making processes of individuals,[439] and at the informal values, culture, and networks that are specific to each organization.[440] And regulators, sentencing guidelines, compliance recommendations, and settlement contingencies, should reward corporations that proactively do so. Likely, the government does not have the time, resources, or the capability to conduct a refined analysis for every allegedly malfeasant company. Therefore, the government should offer liability mitigation

435. Granted, realism is hard to capture in rules.

436. *See supra* notes 428 and 92 and accompanying text. *Cf.* Pearce & Wald, *supra* note 186, at 534 (arguing that the cultural influence of command and control regulation (whether governmental or internal corporate) is weak and that principles based regulation is stronger so long as its implementation is participatory)

437. Richard B. Stewart, *Administrative Law in the Twenty-First Century*, 78 N.Y.U. L. REV. 437, 446 (2003).

438. Pierre Schlag, *Rules and Standards*, 33 UCLA L. REV. 379, 388 (1986) (explaining that the principles-based approach "places the onus on the parties to work out and communicate their intentions completely and thoroughly"); Dan Awrey, *Regulating Financial Innovation: A More Principles-Based Proposal?*, 5 BROOK. J. CORP. FIN. & COM. L. 273, 275 (2011) (explaining that principles-based regulations support communication and interaction between those drafting the rules and those required to implement the rules); Andrew Boon, *Professionalism under the Legal Services Act 2007*, 17 INT'L J. LEGAL PROF. 195, 195 (2010) (explaining that under a principles-based approach there is more communication around the objectives of the principles leaving the practical application decisions to those subject to their application). Ted Schnayer is known for his recommendation for a principle-based approach to law firm regulation. *See also* Ted Schneyer, *On Further Reflection: How "Professional Self-Regulation" Should Promote Compliance with Broad Ethical Duties of Law Firm Management*, 53 ARIZ. L. REV 577, 619–28 (2011) (recommending a principle-based approach to law firm regulation) (For a description of Ted Schneyer's work and recommendations, see Pearce & Wald, *supra* note 185 at 529–32.)

439. *Cf.* BAZERMAN & TENBRUNSEL, *supra* note 128, at 126 (making similar argument); *id.* at 160–61.

440. *Cf. id.* (making a similar point).

to those corporations that make changes (whether structural or inherent) based on internal findings about how work is actually being done within the company and the networks and ethical culture that exists beneath the surface of the organization chart, the mission statement, and the code of conduct. Specifically, in order to qualify for the mitigation, corporations should conduct some type of network analysis, like that recommended by Robert Cross and Andrew Parker, to determine communication flow, critical stopgaps, and the informal organization structure that exists based on the way that people behave and interact.[441] Corporations should be required to demonstrate that there was a shared dialogue between executives and employees and that they developed and implemented compliance structure, programs, *and* principles based on the results of this internal study along with input from other employees across the organization.[442]

After performing these recommendations, will the corporation still decide to have a chief compliance officer? Likely. Will the corporation still decide to departmentalize the compliance function so that it does not report to legal? Maybe. Or perhaps, alternatively, it will provide the chief compliance officer with dual reporting obligations—to both the board and the general counsel. The answer depends on the corporation and its internal picture. But without such internal analysis, focus, and dialogue, a corporation (let alone the government) cannot know whether departmentalization (or other programs and policies) will support or distract from compliant culture creation—and importantly—a corporation cannot ensure that a culture of compliance is engrained in the corporate community.[443]

441. CROSS & PARKER, *supra* note 379. Note, this Article is not recommending that the government require ethics audits or self-assessments despite recent research that suggests that self-assessments may incent firms to improve their ethical infrastructure. *See, e.g.*, Susan Saab Fortney, *The Role of Ethics Audits in Improving Ethical Conduct: An Empirical Study on Self-Assessment and Management-Based Regulation of Law Firms* 6-8 (Fordham Ethics Schmooze, Draft 2013), *available at* http://law.fordham.edu/assets/SteinCenter/Fortney_Susan.pdf (describing the recent legislation in New South Wales that allows nonlawyers to own law firms); *see also*, Tahlia Gordon et al., *Regulating Law Firm Ethics Management: An Empirical Assessment of the Regulation of Incorporated Legal Practices*, *in* 37 J. L. & SOC'Y 466 (2010). 37 J.L. & SOC'Y. 466, (2010). This is because, as Hasnas points out, ethical audits that uncover any suggestion of criminal activity may "trigger[] a duty to immediately report the potential violation to the government and fully cooperate in any resulting investigation." Hasnas, *supra* note 5, at 521.

442. *Cf.* Pearce & Wald, *supra* note 186, at 534 (recommending a relational regulatory framework that, *inter alia*, "focuses on how law firms develop and implement their own ethical identities and plans," that "ensures that junior attorneys and staff are part of the processes of creating and implementing an ethical infrastructure" and that "law firms' regulatory objectives should include aspiration" that would "emphasize that lawyers are more than Holmesian bad men and women").

443. BAZERMAN & TENBRUNSEL, *supra* note 128, at 163 ("Because informal values are

VI. CONCLUSION

Do not hover always on the surface of things, nor take up suddenly with mere appearances; but penetrate into the depth of matters, as far as your time and circumstances allow, especially in those things which relate to your profession.[444]

Since the fall of Enron, the issue of corporate compliance with law has been a dominant focus of research, legislation, regulation, and commentary. A key issue in the discussion is how to develop voluntary corporate governance structures to enhance the degree of compliance with law by corporations. Two schools of thought have emerged: departmentalization (separating out the compliance function from the legal department) and non-departmentalization (housing the two departments under the general counsel).

This study contains a critical examination of both schools of thought (and their evolution and implementation to date) and concludes that non-departmentalization likely provides the better route to bolster the level of corporate compliance with law and foster a positive culture of compliance. However, as this article shows, regulatory efforts have tended in the direction of mandating a departmentalized approach—a mistaken direction if this analysis is correct. The purpose of this article is to caution against an uncritical adoption of the departmentalization approach and to set forth the case for use of a non-departmentalization structure as a management strategy and, more importantly, to advocate an approach where corporations delve beyond "the surface of things,"[445] to the internal beliefs, motivations, and hidden norms that affect culture and the choices employees make. The appearance of compliance—whether it is the formal ethics programs and codes of conduct,[446] or the internal corporate structure—have been touted as "the weakest link in an organization's ethical infrastructure" and can be "far eclipsed by their informal counterparts."[447] A mandate for departmentalization may

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organization-specific, ethics "fixes" will depend on those values and be unique to each organization . . . . An organization can't simply "borrow' another organization's formal ethics plan, as so many do; nor can the government mandate particular programs and expect success.").

444. ISAAC WATTS, THE IMPROVEMENT OF THE MIND: OR, A SUPPLEMENT TO THE ART OF LOGIC: CONTAINING A VARIETY OF REMARKS AND RULES FOR THE ATTAINMENT AND COMMUNICATION OF USEFUL KNOWLEDGE, IN RELIGION, IN THE SCIENCES, AND IN COMMON LIFE 13 (1784), *available at* http://archive.org/details/improvementofmin00wattuoft.

445. *Id.*

446. BAZERMAN & TENBRUNSEL, *supra* note 128, at 3, 117, 163.

447. *Id.* at 118 (citing studies in support including one that shows that "formal controls of

have little positive impact on corporate culture if it does not reflect the real values, norms, and ethics of the corporation.[448]

Relying on secondary literature along with interviews of seventy general counsels and compliance officers of S&P 500 corporations across a variety of industries, this study describes the commonly cited arguments for and against a departmentalization approach to management of the compliance function. It then categorizes these arguments into three types: 1) autonomy and independence; 2) transparency and efficiency; and, 3) role arguments.[449]

Utilizing this typology, this article examines the strength of the arguments for departmentalization from the public's perspective. Through this examination, the article uncovers and focuses on the drawbacks to departmentalization that have not been emphasized in the literature and that appear to tip the scales away from departmentalization such as disempowerment of the chief compliance officer, lack of expertise in the compliance department, creation of barriers to collaboration between departments, a decrease in corporate transparency, and the potential rise of lawyers as amoral, legal technicians.

This critical analysis leads to the conclusion that legislatures, regulators, and corporations should not preemptively comply with regulators' preference towards stand-alone compliance departments if the goal is to promote an organization-wide culture of compliance. Instead, a focus on and analysis of a corporation's informal norms may have more potential to meet the objectives than a focus on organizational structure. Without such analysis and focus, a corporation (let alone the government) cannot know whether departmentalization will support or distract from compliance and a normative commitment to compliance and ethics.[450] Therefore, corporations should make changes to compliance procedures and policies based on internal network studies to determine work and communication flow as well as explore the ethical culture that exists beneath the surface of the organization chart, the mission statement,

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managers were inferior to the informal social controls imposed by coworkers"); *see supra* note 373.

448. BAZERMAN & TENBRUNSEL, *supra* note 128, at 119, 122; *see supra* note 443.

449. Unsurprisingly, these three types of arguments are commonly utilized in debates about the ideology of the legal profession and the rules governing lawyers' conduct. *Cf.* David B. Wilkins, *Everyday Practice is the Troubling Case: Confronting Context in Legal Ethics*, *in* EVERYDAY PRACTICES & TROUBLE CASES 68, 70–75 (Sarat et al. eds 1998) (analyzing assumptions that underlie the image and ideology of the legal profession and how these assumptions affect lawyers' conduct); *see generally* Richard Wasserstrom, *Lawyers as Professionals: Some Moral Issues*, 5 HUM. RTS. 1 (1975) (analyzing professional roles (including the role of lawyer) on moral rights and obligations).

450. BAZERMAN & TENBRUNSEL, *supra* note 127, at 119, 122; *see supra* note 442.

and the code of conduct. Moreover, the government should offer liability mitigation to those corporations that do so.

In sum, this analysis suggests that the government's preference for departmentalization and emphasis on the importance of compliance professionals having autonomy and independence from legal department may be a red herring.[451] The critical elements are informal norms and networks, human ethics, and motivation.[452] If this is true, the job of a compliance officer is measurably more complicated, and the level of influence and power along with the personal, leadership, and communication skills of the compliance officer become even more important. This conclusion, then, leads to an unanswered but important question (one that is left for another day and another article): Regardless of the organizational structure, *who* should oversee compliance? What expertise and skills should these compliance officers have? Should they have legal, management, or other training? Lastly, what roles should compliance officers fill to best execute the compliance function? These questions are beyond the scope of this article, but will be addressed in future articles.[453]

VII. APPENDICES: COMPLIANCE STUDY METHODOLOGY: GENERATING HYPOTHESIS ABOUT THE EFFECTS OF LAWYERS OVERSEEING COMPLIANCE

To explore the central questions of this article, self-reported, hypothesis-generating perceptions of general counsels and chief compliance officers of large publicly traded corporations were studied to examine the compliance function. The study was approached in two stages. Stage one consisted of thirty-six short interviews at the end of longer interviews on a separate topic. Stage two consisted of thirty-five longer interviews that concentrated on the topic of compliance. In total, seventy-one interviews were conducted with seventy professionals (i.e., one general counsel was interviewed in

451. The MacGuffin STAR WARS (1977) Region 2 DVD release (2004). Audio commentary, 00:14:44–00:15:00; (George Lucas describes R2-D2 as "the main driving force of the movie . . . what you say in the movie business is the MacGuffin . . . the object of everybody's search"); OXFORD ENGLISH DICTIONARY (quoting Hitchcock from a lecture at Columbia University in 1939) ("[We] have a name in the studio, and we call it the 'MacGuffin.' It is the mechanical element that usually crops up in any story. In crook stories it is almost always the necklace and in spy stories it is most always the papers.").

452. In other words, the right question is not whether compliance should be independent from the legal department.

453. *See supra* note 24.

stage one and stage two). In both stages, a "snowball sample" approach was used to find potential respondents.[454]

A. RESEARCH METHODOLOGY

1. *Interviews Stage 1*

Stage one interviews occurred in 2006–2007 as part of a separate research project at Harvard Law School to gain a better understanding of how general counsels within large publicly traded companies[455] purchase, monitor, and assess legal services. During the interviews, interviewees were asked about the main topic but also queried about compliance.[456] The interviewees were not told that they would be questioned about compliance and often, the subject of compliance was a natural by-product of the conversation.[457] Of the total interview time (which was, on average, approximately seventy-six minutes),[458] time spent on compliance lasted on average eight minutes. In sum, thirty-six short interviews with general counsels of S&P 500 corporations in banking, pharmaceutical, and petroleum companies were conducted.[459]

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454. Snowball sampling essentially means that initial participants provide connections to other people who meet the study criteria and might be willing to be interviewed by the researcher. *Id.* For a more detailed description, see Leo A. Goodman, *Snowball Sampling*, 32 ANNALS MATHEMATICAL STAT. 148, 148–49 (1961) (defining snowball sampling); Charles Kadushin, *Power, Influence, and Social Circles: A New Methodology for Studying Opinion Makers*, 33 AM. SOC. REV. 685, 694–96 (1968) (discussing the strengths and weaknesses of snowball sampling); *see also*, Jean Faugier & Mary Sargeant, *Sampling Hard to Reach Populations*, 26 J. ADVANCED NURSING 790 (1997); Sarah H. Ramsey & Robert F. Kelly, *Using Social Science Research in Family Law Analysis and Formation: Problems and Prospects*, 3 S. CAL. INTERDISC. L. J. 631, 642 (1994). There are many legal research studies based on a snowball sample approach. *See, e.g.*, Chambliss & Wilkins, *supra* note 110 (using a snowball sample to study "the emerging role of compliance specialists in large law firms"); Kimberly Kirkland, *Ethics in Large Law Firms: The Principle of Pragmatism*, 35 U. MEM. L. REV. 631 (2004) (utilizing a snowball sample of twenty-two lawyers practicing in ten large law firms to investigate "how bureaucratic legal workplaces shape lawyers' ethical consciousness").

455. This research study focused exclusively on banks, petroleum companies, and pharmaceutical companies. For a description of the methodology, see, John C. Coates IV, et al., *Hiring Teams from Rivals: Theory and Evidence on the Evolving Relationships in the Corporate Legal Market*, 36 LAW & SOC. INQUIRY 999, 1004–05 (2011).

456. To read a summary and analysis of this study, see Coates et al., *supra* note 455.

457. In some ways, these interviews may be even more valuable than the longer interviews wherein the subjects knew the topic of the interview beforehand and could prepare for the conversation.

458. Coates et al., *supra* note 455.

459. These interviews focused on general counsels working at S&P 500 companies that had high demand for legal services. They were conducted as part of a larger research project funded by Harvard Law School's Center for Lawyers and Professional Services, a subsidiary of Harvard's Program on the Legal Profession. At that time, I was the Associate Research Director of the Center and the lead researcher on the project. The Harvard Law School faculty

2. *Interviews Stage 2*

Stage two interviews occurred in 2010–2012. To elicit participation, the interviewees in this stage were contacted by email on average one to two times. They were told that the topic was the way in which compliance was handled and structured at large publicly traded corporations. They were also assured that they and their companies would remain anonymous.

A total of thirty-five interviews were conducted that averaged approximately sixty minutes in length. All of the interviews in this stage were over the phone and consisted of both closed and open questions. Interviews were conducted across nine industries: Financial Services, Petroleum, Pharmaceutical, Health Care, Consumer Products, Professional Services (marketing, outsourcing, and communications), Electric/Energy, Government, Transportation & Logistics. The goal was to conduct 30–40 interviews: two to three companies per industry, some general counsels and compliance officers from the same company, some ex-general counsels from the same industries in this sample, a few lower level compliance employees, a couple compliance activists, and a couple senior people that used to work in compliance at the SEC or OIG of public health. In total, interviews were conducted with twelve general counsels,[460] nine chief compliance officers, five compliance officers, five former general counsels,[461] one chief ethics officer,[462] one former compliance officer for the SEC, and one from the DHHS, and one compliance activist (a consultant that also serves as the leader of an organization on compliance).[463]

B. METHODOLOGY LIMITATIONS AND CAVEATS

Admittedly, this methodology suffers from many deficiencies. First, clearly it is impossible to generalize findings based on one study. Second, with only thirty-six units in Stage one and thirty-five units in stage two, the study also suffers from small sample size. Third, given that it is the informal cultures that cannot be seen from the outside that most affect compliance behavior by employees, it is

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directors of the project were John Coates, David Wilkins, and Ashish Nanda. The director of the American Bar Foundation, Robert L. Nelson, was also a key collaborator. For more information about the larger research project *see* Coates et al., *supra* note 455.

460. One of these general counsels was an associate general counsel.

461. One of these former general counsels was a former associate general counsel. Also one of these general counsels was also interviewed in stage one. Also, the compliance activist was also a former general counsel—so this number could be reported as six.

462. This chief ethics officer reported to the chief compliance officer.

463. See the charts detailing sample characteristics in section C of this Appendix.

hard as an interviewer to determine that which is merely "talk," and that which is clearly the corporate culture, the internal norms and pressures that affect how employees make decisions. To that end, a codebook was developed that consisted of two parts.[464] The first part measures questions that were able to elicit specific answers in order to systematically tabulate responses across interviewees. For the most part, the topics were presented in an open-ended fashion and, therefore, the second part of the codebook is an analysis of the interview transcripts by question and topic.[465] Some of this coding is used in the second article related to this study. Various law-student research assistants were trained to code the data. Of course, the findings are not statistically significant nor are they relied on to show or prove any point empirically. As indicated by the sample size the real nature of the approach is qualitative, not quantitative, in character.

Finally, the compliance study is not comprised of a random sample of all large publicly traded companies that have high demand for legal services. Instead, it is self-reports by senior executives who arguably have certain stories to tell. However, the primary goals of this article are to understand how general counsel and chief compliance officers of some large, publicly traded corporations define, manage, and think about compliance and to initiate a normative discussion about the government's unofficial stance that compliance be separated from legal and all the assumptions that go into such a stance (assumptions about the role of lawyers, the impact organization structure has on communication, and how ethical or "compliance" decisions are made). Essentially, this study represents an attempt to merge what could be a purely conceptual and normative exercise with descriptive interviews that provide a lens through which to view the normative discussion. The interview research is not designed or used to prove anything about general counsels or compliance officers generally. It is quasi-empirical and not set up to yield results that might be subjected to standard statistical tests which would indicate variables of significance. Instead, it (along with secondary material and other research on compliance) informs the analysis and conclusions. In sum, the

464. This is an attempt at quasi-content analysis, which is a type of analysis often used for analyzing transcripts, political speeches, advertisements, judicial opinions. *See, e.g.*, KLAUS KRIPPENDORFF, CONTENT ANALYSIS: AN INTRODUCTION TO ITS METHODOLOGY 26–29 (Sage Publications 2004).

465. This approach is similar to that taken by Nelson & Nielsen, *supra* note, 183. However, sample sizes and procedure differ. *Id.* at 460. Although both conducted interviews, Nelson and Nielson "cross-check[ed] their results by comparing randomly and nonrandomly selected informants." *Id.* at 460–61.

interviews are not use to depict a true picture of how the world is but instead—as other qualitative interviewers have proposed—to paint a picture of how "some professionals *believe* the world is or how it *ought* to be or how they would like others to believe they see the world."[466]

C. SAMPLE CHARACTERISTICS

1. *Interviews Stage 1 by Industry*

Industry	Number of Interviews	Recorded & Transcribed?
Financial Services	29*	26
Petroleum	6	6
Pharmaceuticals	1	1
TOTAL	*36*	*33*

*One company had co-general counsels. The interview with the two of them is counted as two interviews.

2. *Interviews Stage 2 by Industry*

Industry	Number of Interviews	Recorded & Transcribed?
Financial Services	8	3
Petroleum	1	1
Pharmaceuticals	4	3
Health Care	5	3
Consumer Products	5	4
Professional Services (including marketing, communications, and outsourcing)	3	2
Hospitality	1	0
Electric/Energy	2	1
Government	2	2
Transportation & Logistics	4	4
TOTAL	*35*	*23*

466. *See* Parker, *supra* note 1, at 341. Examination of narratives is a method used successfully in other areas of study, e.g., critical legal studies literature. Further, the number of interviews in this study meets or exceed the number of interviews considered in other scholarship which uses similar methods to research this topic area and other topics in the legal profession. *See supra* note 25 (describing other qualitative studies on compliance). Ideally, use of a narrative methodology would be an intermediate step which would lead to the construction of a more rigorous theory which might be then subject to modeling and testing. With this subject matter, however, it is not clear such a next step is possible.

Industry	# of companies interviewed the GC and Compliance officer from the same company in stage two
Financial Services	2
Pharmaceuticals	2
Health Care	1
Hospitality	1
Transportation & Logistics	1
TOTAL	*7*

3. *Interviews Stages 1 & 2 by Title and Reporting Structure*

In total, 71 interviews were conducted of 70 general counsels and compliance officers. One general counsel was interviewed in both stage one and stage two.

Title	Stage	TTL	Industry	Code Name	Who report to?
General Counsels*					
	1	1	Financial	GC1	Chief Risk Officer
(Associate General Counsel)	1	2	Financial	GC2	General Counsel
	1	3	Financial	GC3	Chief Executive Officer
	1	4	Financial	GC4	Chief Financial Officer
	1	5	Financial	GC5	Chief Legal Officer
	1	6	Financial	GC6	Chief Executive Officer
	1	7	Financial	GC7	Chief Executive Officer

Title	Stage	TTL	Industry	Code Name	Who report to?
	1	9	Financial	GC9	Chief Executive Officer
	1	10	Financial	GC10	Chief Legal Officer
	1	11	Financial	GC11	Chief Executive Officer
(Associate General Counsel)	1	12	Financial	GC12	General Counsel (who reports to CEO)
	1	13	Financial	GC13	Chief Executive Officer
	1	14	Financial	GC14	Chief Executive Officer
	1	15	Financial	GC15	Chief Executive Officer
	1	16	Financial	GC16	Chief Executive Officer
	1	17	Financial	GC17	Chief Executive Officer
	1	18	Financial	GC18	Chief Executive Officer
	1	19	Financial	GC19	President
	1	20	Financial	GC20	Chief Executive Officer
	1	21	Financial	GC21	Chief Executive Officer

Title	Stage	TTL	Industry	Code Name	Who report to?
	1	23	Financial	GC23	Chief Executive Officer
	1	24	Financial	GC24	Chief Administrative Officer
	1	25	Financial	GC25	Chief Executive Officer
	1	26	Financial	GC26	Chief Administrative Officer
	1*	27-28	Financial	GC27	Unknown
	1	29	Financial	GC28	Unknown
	1	30	Financial	GC29	Vice Chair of legal compliance, PR, and charitable foundations
	1	31	Financial	GC30	N/A
	1	32	Financial	GC31	Chief Executive Officer
	1	33	Petroleum	GC33	Chief Executive Officer
	1	34	Petroleum	GC34	Chief Executive Officer
	1	35	Financial	GC35	N/A
	2	36	Pharmaceutical	GC1	Chief Executive Officer

Title	Stage	TTL	Industry	Code Name	Who report to?
	2	38	Financial	GC3	Unknown
	2	39	Consumer	GC4	Chief Executive Officer
	2	40	Transportation	GC5	Deputy General Counsel
	2	41	Pharmaceutical	GC6	Chief Executive Officer
	2	42	Financial	GC7	Chief Executive Officer
	2	43	Health Care	GC8	Chief Executive Officer
	2	44	Hospitality	GC9	Chief Executive Officer
	2	45	Financial	GC10	Chief Operating Officer and Chief Executive Officer
	2	46	Professional Services	GC11	Chief Executive Officer
(Associate General Counsel)	2	47		GC12	General Counsel
Chief Compliance Officer					
	2	48	Pharmaceutical	CCO1	Chief Executive Officer

Title	Stage	TTL	Industry	Code Name	Who report to?
	2	49	Pharmaceutical	CCO2	Chief Executive Officer
	2	50	Financial	CCO3	Unclear if CEO or Board of Directors
	2	51	Financial	CCO4	General Counsel
	2	52	Transportation	CCO5	General Counsel
	2	53	Consumer	CCO6	General Counsel
	2	54	Professional Services	CCO7	Unknown
	2	55	Health Care	CCO8	Quality Compliance and Ethics Committee for the Board
	2	56	Transportation	CCO1 4	General Counsel|
Compliance Officer/Mana ger					
	2	57	Consumer	CO9	Chair of Audit Committee
	2	58	Hospitality	CO10	General Counsel
	2	59	Financial	CO11	Chief Operating Officer
	2	60	Consumer	CO12	General Counsel
	2	61	Health Care	CO13	Global Compliance Officer

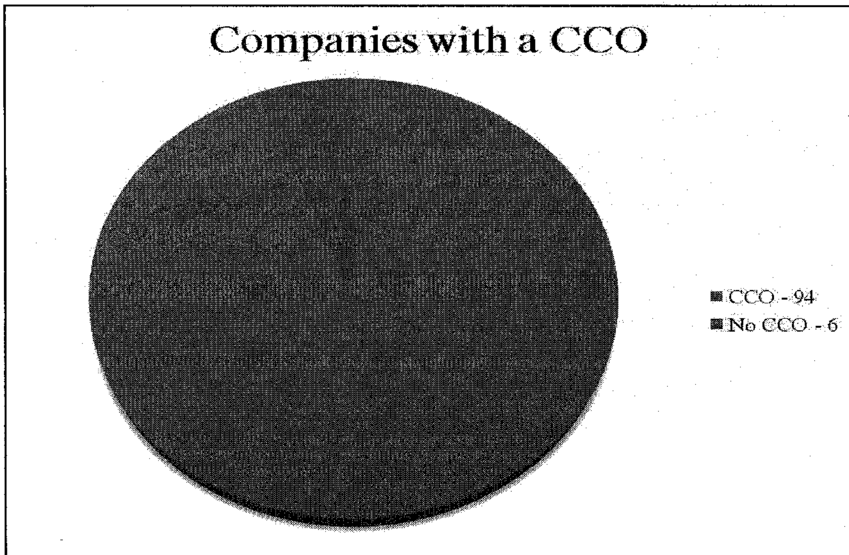
Title	Stage	TTL	Industry	Code Name	Who report to?
Former General Counsel					
	1	62	Energy	FGC1	Chief Executive Officer
	1 & 2**	63	Petroleum	Stage 2 FGC2/ Stage 1 GC32	Chief Executive Officer
	2	64	Financial	FGC3.	Unknown
	2	65	Consumer	FGC4	Unknown
(Former Assoc. GC)	2	66	Consumer	FGC5	General Counsel
`Compliance Activist					
(also an ex GC)	2	67	Financial	CA1	Varied
Former Compliance Government Official					
	2	68	Government	CGO1	Someone in DHHS
	2	69	Government	CGO2	Someone in SEC

Title	Stage	TTL	Industry	Code Name	Who report to?
Chief Ethics Officer					
	2	70		CXO15	Chief Compliance Officer

*Two Interviews at the same time with co-general counsels – counted as two interviews.

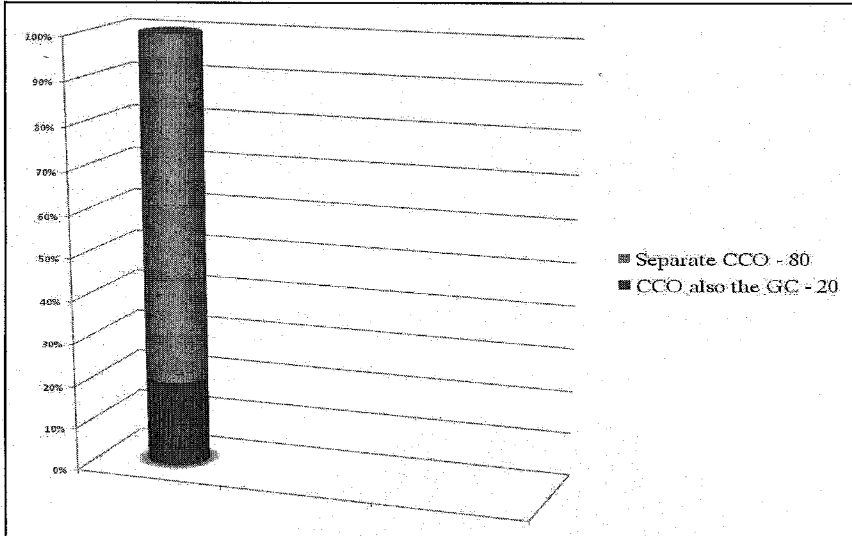
** Interviewed in both stages but only counted once.

D. RESEARCH ON 63 COMPANIES IN TOP 100 OF FORTUNE 500[467]



467. This research was conducted based on publicly available information. However, information could not be found for 37 of the 100 companies.

2013 Compliance Research on 63 Companies in Top 100 of Fortune 500



Is the CCO also the GC?