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RESISTANCES TO REFORMING CORPORATE GOVERNANCE: THE DIFFUSION OF QLCCS

Robert Eli Rosen*

INTRODUCTION

The Securities and Exchange Commission ("SEC" or "Commission") "encourages" company boards to form committees with responsibility to receive reports from attorneys regarding possible legal noncompliance "as a means of effective corporate governance." The SEC accords benefits to companies that establish such committees, provided that the committee meets certain qualifications. A Qualified Legal Compliance Committee ("QLCC") is composed of independent directors, one of whom must be a member of the audit committee. It receives and investigates reports from attorneys working for the company who have credible evidence of material violations of laws, regulations, or breaches of fiduciary duties. The QLCC makes recommendations to the entire board, the chief executive officer ("CEO"), and the general counsel or chief legal officer ("CLO"). A QLCC institutionalizes at the board level the company's responsibility to obey law.

The SEC estimated that approximately 20% of "issuers" would adopt QLCCs, although it admitted that "[t]he Commission does not know how

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2. 17 C.F.R. § 205.2(k) (2005). A QLCC is "established by the issuer's board of directors." Id. § 205.2(k)(3).

3. Id. § 205.2(h). An "issuer" is defined as follows: [A]n issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. § 78c) [2000], the securities of which are registered under section 12 of that Act (15 U.S.C. § 78l) [2000], or that is required to file reports under section 15(d) of that Act (15 U.S.C. § 78o(d) [2000]), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15

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widespread adoption of the QLCC alternative will be.”

The Commission estimated that, of the approximately 18,200 issuers subject to the rule, 3640 issuers would form QLCCs. Between October 2002 and September 30, 2005, however, only 456 entities formed QLCCs. Thus, 97.5% of issuers have not yet adopted this means of corporate governance, and over 87% of those the SEC estimated would adopt the QLCC have not yet done so. Over 96% of the companies listed on the New York Stock Exchange (“NYSE”) have not established QLCCs. At the moment, not only are the numbers small, but only about one-half as many companies established QLCCs in the year ending September 30, 2005, as in the previous year. For issuers who are "operating companies,"—that is, issuers who are not registered companies under the Investment Company Act of 1940 ("1940 Act")—the number of companies adopting QLCCs this year (forty-two) is about one-quarter of those in the year ending September 30, 2004. On the other hand, "investment companies," issuers that are registrants under the 1940 Act (i.e., mutual funds and investment trusts) established QLCCs in comparable numbers in 2004 (108) and 2005 (106). Based on last year's numbers, investment companies will be an increasing proportion of the small number of companies that establish QLCCs. Why?

I approach board adoption of QLCCs as a question of diffusion. Why has this innovation not become contagious among operating companies? Why has it become much more contagious among investment companies?

5. Id. at 6316.
6. Id.; see also id. at 6316 n.132 (explaining the basis for the estimate).
7. The data is described in greater detail infra in Part I.A. The data collection methods used are described infra in note 36.
8. I compared the list of companies that have formed QLCCs in the appendix, with the NYSE Listed Company Directory, http://www.nyse.com/about/listed/listed.html (last visited Nov. 3, 2005). One hundred and five New York Stock Exchange ("NYSE") listed companies have formed QLCCs, and the NYSE "lists close to 2,800 companies." New York Stock Exchange, http://www.nyse.com/about/listed/1089312755443.html (last visited Nov. 5, 2005). One hundred and five is 3.75% of 2800.
9. An “operating company” is “a typical company . . . outside the investment management business whose primary purpose is the provision of goods or services and not simply the investment of assets.” William A. Birdthistle, Compensating Power: An Analysis of Rents and Rewards in the Mutual Fund Industry, 80 Tul. L. Rev. (forthcoming Dec. 2005).
12. There is extensive literature on the diffusion of innovations. For a partial review of the literature and a discussion of the applicability of diffusion of innovations to socio-legal studies, see William Twining, Social Science and Diffusion of Law, 32 J.L. & Soc'y 203 (2005).
In addressing these questions, I assume that innovations are spread by communications from change agents, and I examine the arguments these agents have advanced for and against QLCCs. In this Article, I focus on corporate lawyers as the relevant change agents, because, in deciding whether or not to form QLCCs, company boards "are likely to rely heavily on... their attorneys' advice."14

In adopting a diffusion perspective, I reject the notion that the nonappearance of QLCCs is simply a matter of inertia. I take seriously the resistance of those who could have tried to spread the innovation: the corporate bar. It may be true, as one lawyer said in an interview, that "upper level management and boards of directors aren't even aware of the fact that the QLCC option exists" and that this ignorance may result, as the lawyer emphasized, from the fact that "CLOs aren't apprising boards and management of the existence of the option."16 And, as the lawyer admitted without emphasizing, the ignorance may also stem from the fact that neither he nor any member of his firm apprises boards or management of the existence of the QLCC option. The adoption of this reform to corporate governance has been actively resisted by both inside and outside counsel.
Contrary to expectations, I find that corporate lawyers either oppose the formation of QLCCs or offer only tepid and cautionary support for them. I examine how their arguments predict the behaviors of executives and directors. I pay attention to the assumptions about social relations contained in the justifications for their resistance.

I treat the decision by issuer boards to adopt or not to adopt QLCCs as a "self-consciously interpretive process." Understanding this cultural construction of meaning helps to explain the fate of QLCCs. As David Strang and Sarah Soule have noted, "Practices that accord with cultural understandings of appropriate and effective action tend to diffuse more quickly than those that do not." I seek to discover why QLCCs are understood as being neither appropriate nor effective for operating companies, and to speculate about why investment advisers might promote QLCCs to the investment companies they administer.

Innovations cannot be studied individually; rather, "innovations compete and support each other." To understand the diffusion of QLCCs, the corporation before and after the innovation's implementation (or non-implementation) must be examined. For example, arguing against QLCCs on the ground that they will cause excessive reporting and thereby waste directorial resources ignores that audit committees are creating

17. See, e.g., Fisch & Gentile, supra note 14, at 546-51 (arguing that both inside and outside counsel will urge boards to form QLCCs); see also Jeffrey I. Snyder, Note, Regulation of Lawyer Conduct Under Sarbanes-Oxley: Minimizing Law-Firm Liability by Encouraging Adoption of Qualified Legal Compliance Committees, 24 Rev. Litig. 223, 245 (2005). Snyder writes as follows:

In addition to avoiding potential liability, attorneys will soon come to prefer QLCC-equipped clients because there is no need or even pressure to embarrass a client, no risk of alienating other clients, and no pressure to evaluate the response received from the up the ladder process to determine if it is an "appropriate response."

Id. (footnote omitted).

18. Strang & Soule, supra note 18, at 278; see also Gerald F. Davis & Heinrich R. Greve, Corporate Elite Networks and Governance Change in the 1980s, 103 Am. J. Soc. 1 (1997).


20. The Investment Advisers Act of 1940 ("Advisers Act") defines "investment adviser" to mean "any person who, for compensation, engages in the business of advising others... as to the value of securities or as to the advisability of investing in, purchasing, or selling securities..." and "person" to mean "a natural person or a company." 15 U.S.C. § 80b-2(a)(11), (16) (2000). In this Article, "investment adviser" refers only to companies providing these services.

21. The interviews for this Article were completed before the data revealed the apparent difference in the rate of diffusion of QLCCs between operating and investment companies. None of the lawyers interviewed worked for investment companies.

22. Strang & Soule, supra note 18, at 285.


24. Fisch & Gentile, supra note 14, at 549; see Jill E. Fisch & Kenneth M. Rosen, Is There a Role for Lawyers in Preventing Future Enrons?, 48 Vill. L. Rev. 1097, 1114, 1130
anonymous complaint hotlines\textsuperscript{25} and that corporations are creating other avenues, such as expanded ombudsmen and compliance functions, for such complaints to reach the board. It is true that the adoption of a QLCC makes it structurally very difficult to block a lawyer who wants to go to the board. But, in the current context, if a lawyer has material evidence of a violation, the lawyer can still get it to the board. What the absence of a QLCC in this context means is only that the reporting lawyer and the corporation will lose the benefits afforded by the QLCC.

The benefits of QLCCs may be analyzed in terms of lawyers' professional responsibilities. Lawyers appearing before the SEC, and lawyers under the recently adopted American Bar Association ("ABA") ethics rules, are permitted to disclose corporate confidential information to prevent certain types of violations and frauds.\textsuperscript{26} An issuer that has established a QLCC, however, gains a safe harbor from some of these disclosures.\textsuperscript{27}

Fear on the part of issuers that lawyers will make permitted disclosures to prevent wrongdoing does not appear to exert much pressure on those issuers to form QLCCs. Only if issuers have formed QLCCs prior to when an attorney "becomes aware" of evidence of a material violation\textsuperscript{28} is an attorney's reporting obligation satisfied by making a report to a QLCC. Yet operating companies are not forming QLCCs to have them on the shelf in case an attorney should feel obligated to make a report to the SEC.

Corporate lawyers also do not appear to be pressured by the potential relaxation of the attorney-client privilege in advocating the formation of QLCCs. The SEC schema induces lawyers to spread QLCCs: The QLCC is presented within the SEC's rules regulating attorney professional conduct\textsuperscript{29} and the SEC presents it as an alternative to the SEC's re-inscription of a lawyer's professional obligations.\textsuperscript{30} The organized bar strongly resisted the SEC's rules revising their normative obligations. Lawyers who work for issuers with QLCCs are relieved from these


\textsuperscript{26} 17 C.F.R. § 205.3(d)(2) (2005); Model Rules of Prof'l Conduct R. 1.6 (2003).

\textsuperscript{27} 17 C.F.R. § 205.3(c). The regulation states as follows: "An attorney who reports evidence of a material violation to such a qualified legal compliance committee has satisfied his or her obligation to report such evidence and is not required to assess the issuer's response to the reported evidence of a material violation," \textit{Id}.

\textsuperscript{28} \textit{Id}.

\textsuperscript{29} 17 C.F.R. § 205 is entitled "Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer."

\textsuperscript{30} 17 C.F.R. § 205.3(c) is entitled "Alternative reporting procedures for attorneys retained or employed by an issuer that has established a qualified legal compliance committee."
contested responsibilities.\textsuperscript{31} Law firms who work for issuers with QLCCs will be protected from associates, or other lawyers whom they hire in the future, making disclosures that the firm feels are inappropriate. Yet lawyers who serve issuers are not advising the formation of QLCCs.

The benefits of QLCCs also may be analyzed in terms of their contributions to corporate governance. The pattern of diffusion of QLCCs suggests that operating company boards will not become involved in legal compliance until they are forced to do so. I draw this conclusion based on two different findings. The diffusion of QLCCs among investment companies is consistent with these findings.

Based on interviews and published accounts regarding QLCCs, I find that lawyers believe that the board is an inappropriate forum for the resolution of legal compliance issues. Lawyers resist board and board committee involvement in legal compliance through an "ideology of managerialism," which makes such involvement culturally inappropriate because legal compliance decisions are understood to be properly the responsibility of executives and chief legal officers. The ideology of managerialism pulls legal compliance decisions away from the board of directors.

Liability standards, I find, push legal compliance decisions away from the board of directors. Knowledge of the risks being assumed by a corporation is the most important information that can flow to a board,\textsuperscript{32} but a board committee concerned with legal compliance requires that directors accept the risk of noncompliance and make determinations of appropriate levels of risk for not complying with the law. A board committee that deals with compliance, such as a QLCC, makes such decisions transparent ones. The board does not seek candor regarding the legal difficulties of corporate action. The directors want to know that an action is "legal," even when in fact it risks noncompliance. Given the uncertain state of board liability for the corporation acting within the bounds of law, directors, often acting on lawyers' advice, will avoid making legal compliance decisions, especially ones defining appropriate levels of noncompliance risk. The diffusion of QLCCs, I conclude, demonstrates limits in "the evolution of business style and structure toward transparency and accountability."

\textsuperscript{31} Id.

\textsuperscript{32} Donald Langevoort has observed the following:

Most day-to-day strategic business decisions need not be shared with the board . . . . What is important on a timely basis, however, is risk disclosure. Extraordinary forms of risk-taking are, by black-letter corporate law doctrine, for the board in any event . . . . Especially in today's business environment, where sophisticated tools for both hedging and assuming risk abound, there is a temptation to assume greater risk in order to satisfy perceived pressures—whether from the marketplace or the board itself—to generate high returns. Thus it is risk-related information that is the underdeveloped substance of the duty of candor we are describing.


Investment companies, on the other hand, do not have employees, especially a general counsel, who will resist board involvement in legal compliance by practicing the ideology of managerialism. Furthermore, investment companies that adopt QLCCs will not do so because of a desire to be involved in compliance issues, but because their investment advisers demand such a committee. For investment advisers, investment company adoption of QLCCs may relieve pressures to limit the advisers' conflicts of interest with the investment company.

To establish these arguments, this Article proceeds as follows. Part I.A presents the data on the adoption of QLCCs prior to September 30, 2005. Part I.B then discusses diffusion processes generally and examines how those processes explain the data. Part I.C explores the context in which these QLCCs have been forming. Part II examines two resistances to diffusion of QLCCs. Part II.A first considers "CLOs at the Coalface," exploring the ideology of managerialism. Part II.B then considers "Directors at the Coalface?", exploring transparent board involvement in noncompliance. In response to these resistances, Part III sketches an argument for an enlarged and un-conflicted secretarial function to assist board involvement in legal compliance.

An examination of the diffusion of QLCCs reveals that corporate governance reforms need to consider that executives (including lawyers) will resist board supervision in the name of professional obligations to corporate stakeholders. The ideology of managerialism impedes directorial control. This examination also reveals that corporate governance reforms will be stymied when reforms do not account for corporations' involvement in legal noncompliance.

An examination of the diffusion of QLCCs provides another perspective on the responsibilities of corporate representation. Lawyers responded to the Sarbanes-Oxley Act ("SOX") in terms of their roles as gatekeepers or whistle-blowers. Considering QLCCs in context reveals that these roles play out on a sideshow. The center stage is the everyday relations between the CLO and the Chief Financial Officer ("CFO").

The usual story is that the legal profession has been the victim of the regulations that the SEC adopted pursuant to SOX. There has been extensive discussion of the law of lawyering being federalized, instead of being produced by bar association-dominated state lawmaking. There has been extensive discussion of the SEC's attack on the lawyer's testimonial privilege, of the imposition on lawyers of gate-keeping responsibilities, and of the ill effects of SOX on the attorney-client relationship.

34. See Harvey L. Pitt, Directors' Newest Responsibility Under Sarbanes-Oxley: Ensuring the Existence of Effective Corporate Compliance and Ethics Programs, Remarks before the Nat'l Ass'n of Corporate Dirs., D.C. Area 5-6 (Nov. 17, 2004), available at www.nacdcapital.org/capital/events/november_17th_2004.pdf (recognizing this resistance but labeling it a "misperception").

The real story is that the corporate bar has been made stronger and richer by SOX. The ability to maintain confidences is a market asset for lawyers. SOX has demonstrated that it is not lawyers' only market asset. In the context of scandals, the SEC has made legal compliance a critical contingency. Inside the corporation, lawyers are assuming an expanded jurisdiction. The SEC has sided with lawyers in their battles for intra-corporate power with the CFOs. Outside counsel are increasingly involved in monitoring financial statements and conducting internal corporate investigations. It is within this context of changing roles that the responsibilities of corporate representation must be examined.

I. THE DIFFUSION OF QLCCs

A. The Data

According to reports filed with the SEC, through a search of the SEC's Electronic Data Gathering, Analysis and Retrieval system ("EDGAR") database, in the approximately three years between October 2002 and September 30, 2005, 456 issuers have formed QLCCs. As illustrated in the following table, in the first year, thirty-five issuers formed QLCCs; in the second year, 273 formed QLCCs; and, in the third year, 148 issuers formed QLCCs.

36. The data is derived from a search through Westlaw and Lexis of the SEC's Electronic Data Gathering, Analysis and Retrieval system ("EDGAR") that "performs automated collection, validation, indexing, acceptance, and forwarding of submissions by companies and others who are required by law to file forms with the U.S. Securities and Exchange Commission." SEC, Important Information About EDGAR, http://www.sec.gov/edgar/aboutedgar.htm (last visited Oct. 27, 2005). Most documents required to be filed with the SEC, including proxy statements, are available on EDGAR. This search method is appropriate, as issuers are defined as those who are required to be "registered" or "to file reports" or "registration statement[s]." 17 C.F.R. § 205.2(h) (2005). The companies are listed in the appendix. This method, however, has its limits. It does not capture, for example, that Sun Microsystems formed a QLCC, as reported on its web page on August 29, 2005. See Sun Microsystems, http://www.sun.com/company/cgov/legalcompliance.html (last visited Oct. 31, 2005). This information has not reached EDGAR. (It was not reported in Sun Microsystem's 10-K, which was filed September 13, 2005.) A Google search on "QLCC" and "Qualified Legal Compliance Committees" was performed in June 2005. The first 900 web pages listed in the search results were checked. This search revealed that four other companies, in addition to Sun Microsystems, formed QLCCs: Broadcom, http://investor.broadcom.com/phoenix.zhtml?c=114961&p=irol-govCommittee&Committee=3436 (last visited Nov. 5, 2005); Nelnet, Audit Committee Charter, http://www.nelnetinvestors.net/corpgov-Audit_Committee_Charter.cfm (last visited Nov. 5, 2005); Scientific Games Corp., Compliance Committee Charter, http://www.scientificgames.com/sgcorp/compliance.asp (last visited Nov. 5, 2005); and YP Corp., Audit Committee Charter http://www.yp.com/audit-committee-charter.php (last visited Nov. 5, 2005). These five companies are not included in the statistical analysis, which is restricted to EDGAR. There may be additional companies that have been missed, but I have no reason to believe that their numbers would alter the conclusion that QLCCs are rare, if increasingly less rare among investment companies.
Table 1: QLCC Formation\textsuperscript{37}

<table>
<thead>
<tr>
<th>Year</th>
<th>Operating Companies</th>
<th>Investment Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003:</td>
<td>35</td>
<td>11 (31%)</td>
</tr>
<tr>
<td>2004:</td>
<td>273</td>
<td>108 (40%)</td>
</tr>
<tr>
<td>2005:</td>
<td>148</td>
<td>106 (72%)</td>
</tr>
<tr>
<td>Totals:</td>
<td>456</td>
<td>231</td>
</tr>
</tbody>
</table>

In the last year, the composition of the issuers forming QLCCs dramatically shifted. Of the companies establishing QLCCs between October 2002 and September 30, 2004, 61% were operating companies. In the twelve months since then, only 28% were operating companies. By September 30, 2005, almost equal numbers of operating (231) and investment companies (225) had formed QLCCs. If 2005 patterns continue, operating companies will be a fast shrinking percentage of the total number of issuers who have formed QLCCs.

All of the 456 issuers have audit committees and 324 (71%) have designated their audit committee as a QLCC. Of the operating companies in the population, thirty-seven (16%) have chosen to form independent QLCCs, with the remaining adding the QLCC's responsibilities to those of their audit committee.\textsuperscript{38} Ninety-four of the 225 investment companies (42%) established independent QLLCs. For the investment companies, however, the number of non-audit QLCCs is overstated, as thirty-five formed both their audit committees and their QLCCs by appointing all of their independent directors to them. For these issuers, the QLCC is only formally, but not substantively, independent from the audit committee. If these thirty-five companies are excluded, then 74% of the investment companies assigned their audit committees the additional responsibility of serving as a QLCC.

The only other data on QLCCs of which I am aware is a study reported to have been performed by Skadden, Arps.\textsuperscript{39} Skadden, Arps examined the 6778 companies that filed an annual proxy statement between October 1, 2003, and October 26, 2004. Of these, 165 companies (or 2.4%) had formed QLCCs. Of those companies, the ones listed on the NYSE had a

\textsuperscript{37} The years are measured beginning October 1 of the prior year and ending on September 30 of the year named.

\textsuperscript{38} This percentage of operating companies forming independent QLCCs may be overstated. For example, OmnicomGroup is counted in the data as having created a separate QLCC. But, on inspection, it turns out that "[t]he QLCC shall be comprised of the current members of the Company's Audit Committee." OmnicomGroup Website, http://www.omnicomgroup.com/Governance/_OC223940623/Responsibilities_4 (last visited Nov. 2, 2005). A Skadden, Arps survey found that eighty-two percent (135 of 165) of issuers designated the audit committee as the QLCC. Skadden Arps, QLCC Survey (2004) [hereinafter QLCC Survey] (on file with author). Another ten named the nominating/governance committee as the QLCC, and only twenty (twelve percent) formed a separate QLCC. Id.

\textsuperscript{39} QLCC Survey, supra note 38.
slightly higher rate of QLCC formation (forty-seven of 1664, or 2.8%). These numbers are not incompatible with the ones presented above.

The Skadden, Arps survey emphasized the percentage of NYSE companies with QLCCs. If one looks at the percentage of companies with QLCCs that are listed on the NYSE, a different perspective is provided. Only 15% of issuers are listed on the NYSE (2800 of 18,200). Of the companies with QLCCs, 105 (23%) are listed. In the first year, 34% of the companies forming QLCCs (twelve of thirty-five) were NYSE-listed. In the second year, 26% were NYSE-listed. Between October 1, 2004, and September 30, 2005, 13% of the companies forming QLCCs (nineteen of 148) were NYSE-listed. Although the numbers are too small to have statistical confidence, NYSE listing did initially appear to have an influence on whether a company board decided to establish a QLCC.

Three patterns have been observed in the diffusion of innovations through corporate board actions. The first pattern looks like an elongated "S," with a tail in which there are few adoptions and then a quick jump in adoptions, followed by another tail picking up the laggards. For example, although there was controversy regarding its use, in just two years, 75% of Fortune 200 companies and over 50% of another group of companies began to fully expense their Investment Tax Credit. Similarly, in less than two years, 60% of the 100 largest companies had taken board action to limit the effects of revised NYSE listing requirements. A similar pattern is observed in the adoption of poison pills: In the twelve months following a court ruling that allowed for corporate adoption of poison pills without shareholder approval, 30% of Fortune 500 firms adopted poison pills. Poison pill diffusion had a greater percentage of laggards, and an additional 25% of Fortune 500 firms adopted poison pills over the next three years.

The second pattern of diffusion is characterized by less dramatic but constant growth. This pattern looks like a straight but not very steep line. Golden parachutes, for example, in contrast to the innovations just described, spread more slowly. Golden parachutes experienced constant

growth over a seven-year period in the 1980s, until they were found at 50% of publicly traded Fortune 500 companies.46

The third pattern of diffusion is the absence of significant contagion. Judging from the decline in the numbers of companies forming QLCCs between 2004 and 2005, one might conclude that QLCCs simply will not diffuse. As more time passes from the SEC’s adoption of regulations pursuant to SOX, fewer companies will pay attention to the QLCC alternative. At least until some other shoe drops, the vast majority of companies will ignore QLCC. But judging from only twelve months of data, this conclusion may be too hasty. More important, the broad conclusion that QLCCs will not diffuse does not account for the consistency in the number of investment companies that are announcing in prospectuses QLCC formation.

From the 2005 data, the QLCC adoption process appears to be different for investment than for operating companies. The number of investment companies with QLCCs almost doubled in 2005. This is weak evidence, however, for the diffusion among them following the S-shaped pattern, as it represents only a 3% increase in the number of investment companies with QLCCs.47 But it may indicate that QLCCs will have continuing growth, which may even out to a straight line.

Among operating companies, the diffusion of QLCCs is well captured by two different law firm memos. According to the Skadden, Arps 2004 survey, seven of the Fortune 100 corporations had formed QLCCs prior to October 26, 2004.48 According to a 2004 Shearman & Sterling survey, of the “100 Largest U.S. Public Companies,” sixty had specifically responded to NYSE listing requirements and limited their boards’ responsibility for legal and regulatory compliance prior to June 15, 2004.49

B. Pressures that May Result in Diffusion

The diffusion of organizational innovations results from coercive, mimetic, and normative pressures.50 The exertion of these various forms of pressure upon issuers could foster QLCC adoption.

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46. Davis & Greve, supra note 19, at 3, 29.
48. QLCC Survey, supra note 38.
49. See Shearman & Sterling LLP, supra note 43, at 20. The list of the “100 Largest U.S. Public Companies” was generated from the Fortune 500 list, restricting it to the top 100 companies listed on the NYSE. Id. at 2 n.1.
1. Coercive Pressures

The SEC has not required issuers to form QLCCs. The SEC acts only as a cheerleader for QLCCs, and exerts some pressures and offers some incentives to form them.\(^{51}\) The SEC has not indirectly coerced their formation by requiring lawyers to disclose evidence of violations to the SEC, or to make "noisy withdrawals," unless the organization has a QLCC in place. It has been predicted that, should the SEC mandate disclosure or noisy withdrawals, adoptions of QLCCs will rapidly increase.\(^{52}\)

The SEC provides issuers that have formed QLCCs with the benefit of limiting the obligations of lawyers to demand an appropriate response from the issuer only when the QLCC was formed prior to when an attorney "bec[a]me[] aware" of evidence of a material violation.\(^{53}\) The requirement that the QLCC must be preexisting in order for the issuer to obtain the benefit could exert pressures on issuers to establish QLCCs.\(^{54}\)

Board adoptions of QLCCs also may be coerced as conditions of settlements with prosecutors. The adoption of a QLCC may become part of a settlement agreement to enable the issuer to indicate that it is committed to institutionalizing all "means of effective corporate governance."\(^{55}\) As these settlements are private, it is difficult to determine the extent to which

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51. See, e.g., Pitt, supra note 34, at 9-10 (advising corporations to “[t]reat the sentencing guidelines as if they are formal regulatory requirements” and advising corporations of the benefits of QLCCs).


53. 17 C.F.R. § 205.3(c) (2005).

54. Of course, this pressure is felt only if the preexisting requirement is understood. At least one company appears to have been misadvised in this regard. For example, Husker AG Processing LLC’s “Code of Ethics for Principal Executive and Senior Financial Officers” provides as follows:

In its discretion, with respect to any particular investigation, the Company Board of Directors, upon a majority vote of the independent directors of the Company, may direct the Audit Committee functions set forth herein to a Qualified Legal Compliance Committee (as described in 17 CFR Part 205, implementing Section 307 of the Sarbanes-Oxley Act), which Qualified Legal Compliance Committee shall have all the rights and obligations established in this Code for the Audit Committee, and as granted by applicable law.

Husker AG, LLC Code of Ethics for Principal Executive and Senior Financial Officers, http://www.sec.gov/Archives/edgar/data/1133555/000114420404003917/v02296_ex99-1.txt (last visited Nov. 5, 2005). The company and the QLCC will not have the rights “granted by applicable law” in the particular investigation that led the board to create the QLCC.

they have occurred. But, in at least one case, a proxy statement announced both the formation of a QLCC and the entry of an agreement with the SEC and the New York Attorney General.\textsuperscript{56}

Anticipation of regulatory action and sanctions also may create pressures to form QLCCs. One factor that the SEC has announced that it considers in settling and sanctioning is whether a company has a procedure for reporting violations to a committee composed solely of independent directors.\textsuperscript{57} U.S. Attorneys’ decisions, too, depend on whether “the directors [have] established an information and reporting system . . . to allow them to reach an informed decision regarding the organization’s compliance with the law.”\textsuperscript{58} Recognizing issuer dependence on regulatory action also can lead to the adoption of QLCCs: The presence of a QLCC can signal compliance to the regulators, fending off investigations or influencing the charging decisions of prosecutors.\textsuperscript{59}


\textsuperscript{59} As one law firm has recognized,

The most important advantage . . . of a QLCC in terms of interaction with criminal authorities, is the potential to convince the prosecutor not to charge the company in the first place. . . . The existence of a substantial and respected QLCC might sway the ultimate decision of a prosecutor or her supervisor. Finally, the government will be dealing with a group of people—the QLCC members and their outside attorneys—significantly removed from the company, which may bring down tensions on both sides and comfort the government when making its final decision.

Joseph T. McLaughlin et al., Heller Ehrman, Qualified Legal Compliance Committee: Policies and Procedures 14 (2003) (law firm memo) (on file with author). Paradoxically, the sentencing guidelines operate so that there may appear to be no need for board oversight. The practice of conditioning sentence reductions on corporations’ telling the government everything as soon as they find it has become so common that the ABA has condemned the practice. See ABA Panels Probe Damage U.S. Tactics May Inflict on Corporate Attorney Privilege, 74 U.S.L.W. 2095 (2005). The American Bar Association ("ABA") House of Delegates in August 2005 approved a resolution that "the American Bar Association opposes the routine practice by government officials of seeking to obtain a waiver of the attorney-client privilege or work product doctrine through the grant or denial of any benefit or advantage." ABA Leaders Counter Recent Assaults on Attorney-Client Privilege, Respect for Judges, 74 U.S.L.W. 2091 (2005). Although lawyers have complained to me that they are being forced to act as the government’s agents, not the corporation’s, they also have said that they see no need for a board process to direct their disclosures. That they see no need for board involvement despite their predicament may derive from the current use of the sentencing guidelines, as the lawyers believe that the board will have no choice but to disclose everything. See infra notes 205-10 (discussing the ideology of managerialism).
Coercive pressures from lawyers who work for an issuer also may result in the diffusion of QLCCs. Lawyers may coerce the diffusion of QLCCs by not working for issuers that do not form them. "It seems likely that many prudent lawyers and firms will decline to represent public companies that lack a Qualified Legal Compliance Committee," predicted the New York County Lawyer's Association ("NYCLA"). The Attorneys' Liability Assurance Society ("ALAS"), whose interests lie in minimizing lawyer malpractice judgments, was one of the few supporters of giving lawyers access to the board through QLCCs, labeling the SEC's provision of the QLCC alternative as "a good example of creative and constructive . . . rule-making." 60

Large firms, especially, might fear liability because they employ large numbers of fresh associates, who may have "unrealistic" ethical standards. "Naïve" attorneys have been predicted to make reports to QLCCs and, accordingly, also may be predicted to be more likely to make reports to the SEC. Large firms have economic incentives to retain clients and are unlikely to reward any of their attorneys who act as squeaky cops. The prospect of evading unfortunate involvements is likely to be discounted against the present loss of all kinds of work subsequent to a voluntary SEC disclosure. The specter of the naïve or ethical associate may well have induced law firms to coerce companies into forming QLCCs.

Apparently, most attorneys are not "prudent," in the language of the NYCLA, not fearful of ethical challenges from their associates, and are willing to risk the liability that may result from material violations they could have blocked had they had access to the board.

Coercive pressures need not be so obvious. For example, if cultural expectations had developed so that boards investigate instances of legal noncompliance as a matter of course, these expectations would have constituted coercive pressure for the adoption of QLCCs. Perhaps surprisingly, even after Enron and subsequent multiple corporate investigations, director prosecutions, and impositions of liability, there appears to be only very weak cultural pressure upon operating companies to form QLLCs.

60. Letter from N.Y. County Lawyers' Ass'n to Jonathan G. Katz, Sec'y of the SEC, available at http://www.sec.gov/rules/proposed/s74502/edrobertson1.htm (last visited Nov. 21, 2005) [hereinafter Letter from N.Y. County Lawyers' Ass'n]. A prudent attorney requires the QLCC to enable her "to avoid the consequences of considering" how to respond to corporate action, where "a mistake . . . or error of judgment could lead to censure or other penalty to the firm as a whole." Id.; see also Fisch & Gentile, supra note 14, at 551.


63. Letter from N.Y. County Lawyers' Ass'n, supra note 60.

64. Weil, Gotshal & Manges LLP warns that "Corporate America remains only a major scandal or two away from another round of regulation. Therefore, a narrow approach to compliance with governance reforms is dangerous, not only from the perspective of the individual corporation, but from the perspective of Corporate America as a whole." Weil,
For investment companies, SEC registration supplies a crucial resource. Investment companies also are more heavily regulated by the SEC than are operating companies. Investment companies are therefore more dependent on the SEC. This greater dependence can cause SEC pressures to be more coercive. This may explain the diffusion of QLCCs among 1940 Act registrants.

Another explanation for the diffusion of QLCCs among 1940 Act registrants is the dependence on the SEC, not of the issuer, but of the issuer's investment adviser. The investment adviser also is dependent on the SEC. Investment advisers may form QLCCs at mutual funds to demonstrate to regulators that the investment advisers are concerned about their conflicts of interest with "their" investment company.

QLCCs at investment companies may be mechanisms of governance, not for the funds, but for their investment advisers. QLCCs at investment companies, however, would give an investment adviser the benefit of limiting its lawyers' obligation to determine whether the investment adviser has made an appropriate response when any of its lawyers discover that the adviser is causing an investment company to commit a material violation. In such a case, a lawyer to an investment adviser would not need to raise the issue with his or her employer (the adviser). She could report the matter to the investment company's QLCC.

Operating company violations of law and breaches of fiduciary duty are normally the result of actions by employees, managers, and executives of the company. In only some cases is the action the product of a conflict of interest between the actor and the company. And, except when top executives are pursuing their own interests, conflict of interest problems would never reach the QLCC, because the company would shut down the agents who are acting on their own, rather than the company's, interests.

Unlike violations at operating companies, however, violations of law and breaches of fiduciary duty for 1940 Act registrants are the acts, not of employees of the investment company, but of affiliated persons and companies, such as promoters, underwriters, investment advisers, administrators, transfer agents, custodians, and outside auditors. Investment companies are externally managed and typically have no employees of their own.

These affiliated persons and companies have inherent and ongoing conflicts of interest with the investment company. There is extensive regulation of these conflicts, such as of purchases and sales of registrant's

65. See DiMaggio & Powell, supra note 50, at 150-51.
securities or the compensation paid to these affiliated persons.

Nonetheless, in early 2004, the SEC saw "a serious breakdown in management controls. [The SEC] observed that, in some cases, the fund was used for the benefit of fund insiders, often the management company or its employees." Even with a majority of independent directors, "a fund adviser is frequently in a position to dominate the board because of the adviser's monopoly over information about the fund and its frequent ability to control the board's agenda."

Unlike at operating companies, all the matters likely to go to a QLCC at a mutual fund or investment trust concern conflicts of interest. And these conflicts may be more difficult to manage than those at operating companies. If the members of an investment company QLCC seek "independent legal counsel," they may hire an attorney even though the attorney has represented the investment adviser in the past, and even if, during the representation of the investment company, the attorney "materially increase[s]" her representation of the investment adviser.

Operating companies can fire executives much more readily than investment companies can fire their advisers. In fact, "the termination of advisory agreements is so rare as to be practically nonexistent." In part, this is because shareholders invest by seeking the wisdom of a particular investment adviser. In one case, shareholders fought to retain a terminated adviser by rejecting the fund's new advisory contract. Investment companies also are constrained in firing their advisers because they lack the internal resources that operating companies possess to carry on during management or board successions. Investment advisers also are entrenched because investment companies lack a market for corporate control.

At investment companies, lawyers who make a report to the QLCC do so about their employer's breaches. At operating companies, lawyers normally report to the QLCC about the corporation's employees' breaches. In most operating company contexts, an attorney who reports to a QLCC has some hope that the company will reward that report by giving the lawyer more work in the future. In the investment company context, as the company does not assign legal work, there is no such hope.

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74. Birdthistle, supra note 9. But see Navellier v. Sletten, 131 Cal. Rptr. 2d 201 (Ct. App. 2003). Birdthistle notes that, "[d]espite the widespread industry abuses, no investment advisor has had its advisory agreement terminated or allowed to lapse." Birdthistle, supra note 9. Michael F. Price, a former industry leader, has said, "You know what the shocking thing to me is? That nobody has had a contract canceled by a board of directors. Even where a chairman was messing around with the fund, the board didn't cancel the contract. What does it take to get fired in this business?" Id. (citations and internal quotations omitted).
75. See Navellier, 131 Cal. Rptr. 2d at 201.
At investment companies, QLCCs “solve” the problem presented by the possibility that a report about the fund adviser’s violation will be going to another employee of the fund adviser, who serves as the fund’s functional CLO or CEO.\textsuperscript{76} Litigation against investment advisers, settlement or anticipation of such litigation, or publicity about the advisers’ conflicts of interest with funds may have led to the diffusion of QLCCs to investment companies.\textsuperscript{77} But the ability of QLCCs to monitor investment adviser violations needs to be demonstrated.

2. Mimetic Pressures

Mimetic pressures also might induce issuers to form QLCCs. Mimetic pressures emerge because the search for certainty leads organizations to behave in a manner that is consistent with what are generally perceived to be the industry’s “best practices.” Business and social contacts among directors also may generate imitative isomorphisms. These contacts produce what has been called “business scan,” and has been used to explain why boards choose to undertake certain actions, such as expansion through takeovers, adoption of poison pills, awarding “golden parachutes” to management, and increasing CEO compensation.\textsuperscript{78}

QLCCs are not now best practices, one might argue, because there are so few QLCCs and, consequently, few directors have been exposed to their virtues. Mimetic pressures will grow as the business community sees more and more QLCCs. Then, they will become part of business scan and QLCCs will diffuse in sufficient number so that imitations will cascade.

The current rate of diffusion, however, cannot be explained by an absence of mimetic pressures. “[C]entral firms to the larger business community” are normally inducers of strong mimetic pressures and key sites for business scan.\textsuperscript{79} General Motors (“GM”) was an early adopter.\textsuperscript{80} What is good for General Motors, however, does not appear to be good for most of the rest of corporate America. Moreover, in addition to GM, boards at Bank One, Bear Stearns, Cell Genesys, Citrix Systems, Clorox, Gap, Hilton Hotels, Johnson Controls, Manpower, MGM, PepsiAmericas, Petsmart, Reynolds America, Sara Lee, Teledyne, Time Warner, and

\textsuperscript{76} In the absence of a CLO, lawyers typically report to a Chief Executive Officer (“CEO”). “But the fund’s CEO, often assigned such a designation for the sake of signing off on fund financial statements, is most likely an officer of the advisor—a potential conflict of interest that should be a red flag for directors.” Directors Need to Choose Plan for Conduct Rules, Fund Directions, July 2003, at 2.

\textsuperscript{77} See Conduct Rules Challenged by Market Timing Investigations, Fund Directions, Nov. 2003, at 5. It should be noted that advisers may have a preference for the fund creating a QLCC rather than hiring an independent (from the adviser) CLO.

\textsuperscript{78} See Strang & Soule, supra note 18, at 273, 275, 279 (listing sources).

\textsuperscript{79} Id. at 276 (citations omitted).

Williams-Sonoma have all adopted QLCCs. Other companies do not appear to want to keep up with these “Joneses.” Thus, there appears to be strong resistance to whatever mimetic pressures exist.

3. Normative Pressures

Normative isomorphic pressures derive from ideas carried by change agents. Besides Congress, regulators, prosecutors, and courts, one group of change agents that might have exerted normative pressures leading to the adoption of QLCCs is the organized bar. The ABA Task Force on Corporate Responsibility’s report (the “Cheek Report”) called for “a committee of independent directors” to meet “regularly [in] executive session” with the CLO “to report concerns” regarding “material violations . . . of law” and breaches of fiduciary duty. The ABA report also recognized that, sometimes, outside counsel may have to communicate directly with the board. It recommended that the board create a committee, such as “a legal compliance committee,” charged “with responsibility to obtain and evaluate . . . information about violations or potential violations of law and breaches of fiduciary duty.” Nonetheless, the ABA has not endorsed QLCCs.

Shareholders also might have applied normative pressures inducing the diffusion of QLCCs. That a significant percentage of the largest corporations have adopted QLCCs suggests that they believe that QLCCs signal, to shareholders, quality governance. Nonetheless, Institutional

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81. See infra app. The QLCC Survey conducted by Skadden, Arps found that thirty-five of the 165 adopters were Fortune 500 companies, with fifteen in the Fortune 250 and seven in the Fortune 100. QLCC Survey, supra note 38. General Motors and Time Warner are in the Fortune 50. See Fortune 500 Companies List 2005, http://www.lead411.com/fortune500a.taf (last visited Nov. 1, 2005).


83. Id. at 40 n.72; see also id. at 69.

84. Id. at 70-71.

85. See Letter from Alfred P. Carlton, Jr., Pres., Am. Bar Ass’n, to Jonathan G. Katz, Sec’y, SEC (Dec. 18, 2002), available at http://www.sec.gov/rules/proposed/s74502/apcarlton1.htm (emphasizing that “[l]egal compliance systems need to be flexible.”); see also Letter from Alfred P. Carlton, Jr., Pres., Am. Bar Ass’n, to Jonathan G. Katz, Sec’y, SEC (Apr. 2, 2003), available at http://www.sec.gov/rules/proposed/s74502/aba040203.htm (“We understand the Commission’s desire to influence corporate governance structures and agree with the desirability of encouraging independent committees to address legal compliance matters. However, we believe that this is best done in other ways, such as stock exchange listing standards, Commission disclosure requirements or recognition of best practices.”).

86. See supra note 83 and accompanying text. However, there is also evidence that corporations that are demonstrably concerned with governance do not necessarily believe that the formation of QLCCs is necessary for quality governance. For example, of the more than seventy companies that have joined Ceres—a voluntary organization with member corporations and investment funds committed to compliance and transparency with respect to economic, social, and environmental performance—only two have formed QLCCs. See Ceres, http://www.ceres.org/ceres/ (last visited Nov. 1, 2005).
Shareholder Services does not include QLCCs as a factor in rating quality corporate governance. In the 2004 proxy season, among the 100 largest companies, there were no shareholder proposals relating to QLCCs.

The SEC remains the main cheerleader for QLCCs. The SEC asserts that QLCCs offer benefits beyond preventing those violations reported by attorneys. A board decision to form a QLCC gives legal compliance increased visibility and legitimacy. The QLCC "may also produce broader synergistic benefits, such as heightening awareness of the importance of early reporting of possible material violations so that they can be prevented or stopped." Even if the QLCC never convenes, the adoption of a QLCC institutionalizes the board's commitment to compliance.

This section has reviewed possible bases for the diffusion of QLCCs. Part II, below, considers the resistance to these pressures. The next section considers the context in which QLCCs are diffusing.

C. The Context

"Where were the lawyers?" Judge Stanley Sporkin's question after the Savings and Loan crisis also was prominently asked after the Enron-led scandals. This call led to a response by lawyers arguing for and against the advisability of new regulation.

Both the call and the response are trumpeted by the instruments of morality and high politics. Any student of corporate law, however,


91. See Lincoln Sav. & Loan Ass’n v. Wall, 743 F. Supp. 901 (D.D.C. 1990). The exact text of Judge Stanley Sporkin’s question reads as follows:

Where were these [accountants and lawyers], a number of whom are now asserting their rights under the Fifth Amendment, when these clearly improper transactions were being consummated?

Where also were the outside accountants and attorneys when these transactions were effectuated?

What is difficult to understand is that with all the professional talent involved (both accounting and legal), why at least one professional would not have blown the whistle to stop the overreaching that took place in this case.

Id. at 920.

recognizes this call and response. It is the song of *Smith v. Van Gorkom*.93 It is the song of a full employment act for lawyers.94

As the lawyers actually were there, Judge Sporkin’s question is restated in professional tones as, “Why weren’t the lawyers independent?” This question suggests that professional incentives can become aligned with ethical behavior. In light of the failure of professional incentives in the 1990s, “why weren’t the lawyers independent?” is a call for a change in professional incentives. The trumpeted response is that of increased responsibilities for, and restrictions on, lawyers. Less noticed, however, is that the response also includes increased funding of lawyers.

SOX reforms may be understood from a command-and-control perspective. The question “why weren’t the lawyers independent?” is answered by changing ethical and legal directives.

SOX reforms may be understood by examining the organization of the professions. From afar, greater economic independence is a proxy for greater behavioral independence. Rebuilding “professional independence” led to a reimposition of practices in which professionals and people not in the profession do not share control or profits.95 Rebuilding professional legitimacy led to formal divisions of multidisciplinary practices.96

93. 488 A.2d 858 (Del. 1985). In *Van Gorkom*, the Delaware Supreme Court held that the defendant corporation’s board of directors “violated its fiduciary duty of care to shareholders and thus was subject to massive personal liability for failing to devote sufficient attention to process and advocacy before approving a cash-out merger offer which would have given shareholders a substantial premium over the pre-merger market price for their securities.” Jonathan R. Macey, *The Transformation of the American Law Institute*, 61 Geo. Wash. L. Rev. 1212, 1220 (1993).

94. See Macey, supra note 93, at 1221 (predicting that the natural result of decisions like *Van Gorkom* is the “transfer of wealth from the business community to the legal and investment banking communities”). But see Helen M. Bowers, *Fairness Opinions and the Business Judgment Rule: An Empirical Investigation of Target Firms’ Use of Fairness Opinions*, 96 Nw. U. L. Rev. 567 (2002) (finding no change over time in corporate use of fairness opinions or in revenues earned by financial advisers).

95. See, e.g., Model Rules of Prof’l Conduct R. 5.4(d) (2002). The Rule provides that (d) A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if:

1. a nonlawyer owns any interest therein, except that a fiduciary representative of the estate of a lawyer may hold the stock or interest of the lawyer for a reasonable time during administration;

2. a nonlawyer is a corporate director or officer thereof . . . ; or

3. a nonlawyer has the right to direct or control the professional judgment of a lawyer.

Id.

SOX reforms may also be understood by examining their market effects. Accountants lost access to profits from consultants, but they gained internal control and other work. Inside counsel gained compliance work and a more prominent seat at the table (without having to forsake stock options). Outside counsel gained internal investigation work and increased opinion work. Lawyers and accountants are as much the beneficiaries of SOX as they are its subjects.97

The lawyer, qua lawyer, hears SOX and discusses attorney-client privilege. The lawyer, qua businessperson, hears SOX and discusses opportunities for engagements and power.98 Businesspeople, among others, railing about the costs of implementing SOX, are begrudging fees earned by lawyers.

Remember the corporate world before this wave of scandals struck.

Auditors both inside and outside the corporation had fallen under the tutelage of the consultants. Internal auditors faced the outsourcing of their function and external audits were priced as loss leaders to sell consulting services. Auditors curried favor with and sought to become consultants, especially in the Big Five accounting firms.99

Within the corporation, the CLO had fallen under the tutelage of the CFO.100 In the early 1980s, one study found that, of CEOs with graduate training, more had law degrees than any other degree. A greater percentage of these CEOs had JDs (32.1%) than MBAs (30%).101 In the early 1990s,
however, according to another study, more than three times as many CEOs had a finance background as had a legal one.102 During the 1990s, the widespread financial manipulations to influence stock prices furthered the power of the CFO.103

The legal department had become balkanized by the hiring decisions of self-managing project teams.104 Inside counsel found that they could only infrequently gain support for their opinions by reporting up the ladder within the legal department.105 And as compliance became risk management, and as corporate cultures emphasized risk taking, inside counsel had diminished ability to differentiate legal risks from all the other risks that a project faced.106

Corporate law firms were locked in competition internally over compensation and externally over clients. Both corporate legal departments and multidisciplinary practices competed with law firms for work. The Big Five accounting firms were the goliath multidisciplinary practices that, after transforming the European legal profession, were threatening the American bar. Lawyers were jumping ship and doubling their salaries by joining the Big Five. Law firms were reorganizing. Rather than being organized by legal specialization, they were becoming organized by industry and client. In larger firms, “client relationship partners” succeeded, rather than client finders.107

Professional production was demand driven. Commodification, post-Fordist production technologies, and predatory competition marked professional work. Professionals provided that which those who hired them desired.

What has changed?
The last decade of the twentieth century among the U.S. corporate elite resembled the last decade of the nineteenth century among European swells.


102. William Ocasio & Hyosun Kim, The Circulation of Corporate Control: Selection of Functional Backgrounds of New CEOs in Large U.S. Manufacturing Firms, 1981-1992, 44 Admin. Sci. Q. 532, 548 (1999). According to this study, ten years earlier, in 1982, twice as many CEOs had a finance background than had a legal one. Id. This study did not examine graduate degrees. Consequently, it is impossible to know from it how many CEOs, including those who had finance backgrounds, had JD degrees. Nevertheless, it does suggest some skepticism towards the findings reported in supra note 101.

103. Jonathan Weil, What's the PIE Ratio? Well, Depends on What Is Meant by Earnings, Wall St. J., Aug. 21, 2001, at A1 (reporting that more than 300 companies of the S&P 500 improperly capitalized expenses). “In fact, for every dollar of operating earnings S&P 500 companies reported for their most recent three-month periods, 60 cents wouldn’t be there if they hadn’t excluded costs that are ordinary business expenses under GAAP [Generally Accepted Accounting Principles].” Id.


105. Id. at 665-66.
106. Id. at 666-67.
107. Id. at 672-75.
Both were times of riches and decadence. Both were times in which there was a sense of escape from old-fashioned rules. The new rules in Europe were synthesized as a movement called modernism. The new rules among the U.S. corporate elite were synthesized as the new information economy. Both were times of social disintegration, the rise to political power of heretofore marginalized groups, and culture wars. And both were times of scandal. If there is now a backlash against the immediate causes of our fin de siècle scandals, it may be temporary, as the underlying causes have not changed.

Amidst unchanging larger patterns, however, SOX reforms have led to intra-corporate political shifts. Three changes deserve mention. Auditors have regained status and power. The CLO has been empowered in relation to the CFO. And legal departments have become powerful players in compliance work. In addition, outside counsel have increased compliance and governance work, as well as an increased number of "independent" internal investigations.

SOX section 404 internal controls requirements have led to the resurgence of internal auditors. The internal audit function has also been empowered by the increasing status of external auditors. The spin-off of auditing from multidisciplinary practices has been well funded by the responsibilities that the SEC has placed on the audit committee.

SOX made law a critical contingency for corporations. One survey of corporate directors found that over eighty percent of directors believed that SOX gave CLOs a great deal of responsibility to prevent future scandals. This response rate in 2004 was thirty percent higher than that given in 2003.

SOX led to the CLO being called on more and more in important management decisions. The required certifications by the CFO and CEO


109. "The legal star does appear to be on the rise at many corporations. . . . [G]overnance and compliance duties have 'raised the general counsel to almost the same level (as) the CFO,' says Thom Weatherford, a retired finance chief. . . ." Craig Schneider, You Have the Right to an Attorney, CFO.com, Aug. 20, 2003, at 1 (on file with author). "[T]hese rules will actually strengthen the relationship between the CEO and CFO and general counsel and cause them to spend more time together," said a general counsel. Id. The competition continues: After SOX, "CFOs already have begun recasting their role as 'corporate watchdogs,' vouching for their firms' integrity." Zorn, supra note 100, at 363.

110. Workloads for Corporate Governance Attorneys Pile Up a Year After Sarbanes-Oxley, Of Counsel, Sept. 2003, at 1.


112. Id. at 2.

113. Id. at 7 (stating that approximately 42% of corporate directors believed that their general counsel have become more integrated in client business teams since SOX, while only 2.37% of surveyed directors believed that counsel had become less integrated). Not only
led to the creation of financial disclosure review committees, in which CLOs meet with CFOs and CEOs.114 Michael D. Fricklas, General Counsel of Viacom, said the effect of SOX is that “I’m attending more meetings than I used to. There’s a highest-level closing meeting where the auditors meet with the CEO. That traditionally wasn’t a meeting that included general counsel. Now I’m in those meetings.”115 Inside the corporation, lawyers who used to report to the CFO now report to the CLO: “[T]his is the moment for the legal department to gain absolute control over all legal activities.”116

In making law a critical contingency, SOX led to the empowerment of compliance officers. As a result of the scandals, “compliance officers are being given far more responsibility and resources. ‘This is a tremendous sea change. . . . Now, the compliance officer will report directly or indirectly to the board of directors.’”117 At other times, inside counsel shunned the compliance role, fearing that being the “corporate conscience” would exclude them from important decisions.118 In the post-SOX environment, compliance has become an essential element in important corporate decisions. Susan Hackett, of the Association of Corporate Counsel (“ACC”), advised inside counsel to “[t]ake advantage of the passage of . . . Sarbanes-Oxley” and to “[u]se this opportunity to position the legal department as a center of . . . institutionalizing . . . compliance initiatives.”119 In response to the scandals, the ABA recommended that

SOX, but also the ABA’s Cheek Report, are designed to improve corporate governance by “elevating the role of the general counsel with respect to interaction with the board.” Michael W. Peregrine et al., ‘Up the Ladder’ Counsel Reporting Processes for the Nonpublic/Nonprofit Corporation, Corp. Accountability Rep. (BNA), Apr. 16, 2004, at 423, 425; see also Cheek Report, supra note 14, at 32 (listing Recommendations 6, 7(a), and 7(b)).

114. See Foley & Lardner LLP, supra note 80, at 4-5 (quoting David Sherbin, General Counsel and Secretary of Federal-Mogul corporation, discussing his company’s financial disclosure review committee); Martindale-Hubbell, Setting Standards . . . Creating Protocols, Counsel to Counsel Connections, Summer 2003, at 12, available at http://www.martindalehubbell.com/pdf/c2c/Connections_2003_Summer.pdf; The Roundtable, supra note 98, at 44 (comments of S. Arieh Zak, Vice President of Regulatory Affairs and Corporate Counsel, Datascope Corp., and Thomas A. Gottschalk, Executive Vice President of Law and Public Policy, General Motors Corp.).

115. The Roundtable, supra note 98, at 46.


“[t]he general counsel of a public corporation should have primary responsibility for assuring the implementation of an effective legal compliance system under the oversight of the board of directors.”

After SOX, “more ethics and compliance programs are being run by the corporation’s general counsel.” It is increasingly a “common practice of GCs [to] assume[e] the role of Compliance Officer.” Risk managers are increasingly reporting to the CLO. In one survey, 76.8% of CLOs reported that they had initiatives underway “for better integration and coordination with corporate risk management and other departments on risk issues.” In 2003, a survey commissioned by the ACC found that risk management reported to the general counsel in about one-third of the companies surveyed, and that compliance reported to the general counsel in more than two-thirds of the companies surveyed.

A large variety of compliance programs and initiatives emerged after SOX. Not all of them involve lawyers, but many do. For example, now at 3Com, compliance is “decentralized,” but at the center is the CLO. The CLO issues quarterly reports to the board, the audit and finance committees, and senior management on compliance. The CLO designs a “Matrix for Ad Hoc Compliance Activities.” To the CLO report the internal audit group, the IP group, the safety, environmental, health and security group, the corporate security investigations group, and the hotline group.

The intra-corporate power of inside counsel is buttressed by changes at outside law firms. Not only are firms developing corporate governance units, they also are designing compliance programs. Law firms are increasingly marketing their abilities to conduct internal investigations.

120. Cheek Report, supra note 14, at 32 (emphasis omitted).
This, too, strengthens inside counsels’ ability to obtain cooperation from corporate management.

The goal of SOX may have been to shift “the de facto balance of power between boards and management towards the de jure model of director primacy.”130 Direct indicators of this shift are difficult to detect. The rate of diffusion of QLCCs, however, is an indirect indicator that the balance of power has not shifted. So too may be the announcement that the ACC has “join[ed] forces” with the National Association of Corporate Directors.131 This alignment may reflect directors’ gaining information, but it also might indicate an additional avenue for co-opting directors.

Both developments, however, take place in the context of the altered intra-corporate power of the CLO. SOX has achieved important results. It was CFO dominance that helped contribute to the fin de siècle scandals. The observable effect of SOX has been to strengthen the CLO in relation to the CFO.

It is in this context that the diffusion of QLCCs needs to be studied. Having gained intra-corporate power because law is now a critical contingency, CLOs may not feel it necessary or wise to allow for appeals to the board through a QLCC. Power, however, is contestable and variable, so that over time the need for a QLCC depends on the everyday relations between the CLO and the CFO.

The SEC invited companies to name their extant audit committee as the QLCC.132 Seventy percent of the issuers that have formed QLCCs have chosen to give their audit committees the QLCC’s responsibilities and powers.133 A question that needs to be addressed is whether attorneys reporting to an independent QLCC will constitute a more effective means of constraining CFO power than that of attorneys reporting to an audit committee serving as a QLCC.134 Answering this question requires a study for the day when special in-house investigations may be called for.” Executives Say Sarbanes-Oxley May Inspire Companies to Keep Top Lawyers in Reserve, 71 U.S.L.W. 2652 (2003).

131. Frederick J. Krebs & Roger W. Raber, ACCA and NACD Join Forces to Benefit You: Corporate Governance Survey Results, ACCA Docket, Sept. 2003, at 90.
133. See supra note 37 and accompanying text.
134. The audit committee and the QLCC are never totally independent, as a QLCC requires at least one member to be a member of the audit committee. 17 C.F.R. § 205.2(k)(1) (2004). But nominating the audit committee as the QLCC may suggest that a company is not asking the board “to address legal compliance matters that do not relate[] to financial or disclosure issues . . . .” William B. Chandler III & Leo E. Strine, Jr., Views from the Bench: The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State, 152 U. Pa. L. Rev. 953, 981 n.80 (2003). At first glance, the information that may be provided to the QLCC is broader in scope than that provided to the audit committee. While the audit committee must adopt procedures to receive complaints “regarding accounting, internal accounting controls, or auditing matters,” Sarbanes Oxley Act of 2002, Pub. L. No. 107-204, § 301(4), 116 Stat. 745, 776 (codified as amended at 15 U.S.C.S. § 78j-1 (LexisNexis 2005)), the QLCC may receive complaints of
of issuers with QLCCs. Lacking such data, this Article turns next to opposition to forming QLCCs in the first place.

II. RESISTANCES TO THE DIFFUSION OF QLCCS

A. Lawyers at the Coalface

A QLCC is a crisis management device. Those who resist its adoption have portrayed the QLCC as a regularly used, highly active committee. In reality, however, the QLCC is a fire alarm. When it is tripped, engines are set in motion. But generally it remains untouched.

In filing after filing, companies report that “for the fiscal year ended . . . , the Board’s QLCC held no meetings.”¹ My research has only been able to discover one company at which a QLCC has ever been called into action.¹³

That QLCCs are generally dormant is to be expected. A board may choose to permit only attorneys to report to the QLCC.¹³⁷ Consequently,

any “material violation of an applicable United States federal or state securities law, a material breach of a fiduciary duty arising under United States federal or state law, or a similar material violation of any United States federal or state law,” 17 C.F.R. § 205.2(e). A “breach of a fiduciary duty” refers to “any breach of a fiduciary or similar duty to the issuer recognized under an applicable Federal or State statute or at common law, including but not limited to misfeasance, nonfeasance, abdication of duty, abuse of trust, and approval of unlawful transactions.” 17 C.F.R. § 205.2(d). But the SEC has taken the position that “information regarding misconduct involving illegality, undisclosed self-dealing, or conduct otherwise bearing on managerial integrity” is presumptively material to investment decisions. Manning Gilbert Warren III, Revenue Recognition and Corporate Counsel, 56 S.M.U. L. Rev. 885, 903 (2003); see also Cynthia A. Williams, The Securities and Exchange Commission and Corporate Social Transparency, 112 Harv. L. Rev. 1197, 1277-82 (1999) (arguing that shareholders desire knowledge of a corporation’s compliance behavior).


¹³⁶ See infra notes 185-88 and accompanying text. That a QLCC is a crisis management device, not expected to be much used, is supported by the large number of companies that have named their already overburdened audit committee as their QLCC.

¹³⁷ Under 17 C.F.R. § 205.2(k)(2), a QLCC “adopt[s] written procedures for the confidential receipt, retention, and consideration of any report of evidence of a material violation under § 205.3.” Section 205.3 refers only to attorneys, consequently, a QLCC is free to adopt procedures that limit reporting duties to attorneys. Companies have so limited their QLCCs. See, e.g., Advo, Inc., QLCC Charter 1, (2004) http://www.advo.com/document/ADVO%20-%20Qualified%20Legal%20Compliance%20Committee%20Charter,0.pdf (“The QLCC shall review any report by an attorney employed
they are only roused in the rare event that an attorney discovers evidence of a material violation.\textsuperscript{138} In addition, the QLCC is only roused when that attorney—caught between “going along to get along” and social or civic responsibilities—does not negotiate a settlement with either management or the CLO.\textsuperscript{139} As all the parties have interests in continuing relations, only unmanageable conflicts get to the QLCC.

Yet, QLCCs are described as causing multiple false alarms:

The unwary QLCC . . . might find itself the recipient of an overwhelming number of reports (covering everything from trivial gripes to allegations of entity-threatening frauds), all made by folks who would . . . rather report their concerns directly to the top than to a tip line. . . . [A] QLCC . . . could easily receive 20-50 complaints every year.\textsuperscript{140}

Employees generally are reluctant to report problems to their supervisors. Their reasons range from the obvious economic ones to those relating to the desire to maintain friendships.\textsuperscript{141} SOX’s mandate that lawyers report up the ladder presumes that they, too, face economic and social pressures to “get along.” The QLCC is structured so that an attorney cannot report to it without implying that the CLO and CEO are untrustworthy or involved in noncompliance.\textsuperscript{142} So why should lawyers be expected to overreport? The above quotation’s answer is that lawyers do not respect hierarchy and prefer to speak “to the top.” A QLCC will enable the expression of these attitudes.

or retained by the Company or its subsidiaries.”); Intermune, Inc., Compliance/Qualified Legal Compliance Committee, Procedures for Reports of Material Violations, app. A, at 1, http://www.intermune.com/pdf/charter_compliance.pdf (last visited Nov. 21, 2005) (stating that the QLCC will receive evidence of violations from “attorneys appearing and practicing before” the SEC); Petroleum Development Corp., QLCC, Procedures for Confidential Reporting, Retention and Consideration of Sarbanes-Oxley Act Sec. 307 Reports to the QLCC 1, http://www.petd.com/ (last visited Nov. 21, 2005) (establishing a “direct dial QLCC Hot Line” only for “[a]ttorneys employed or retained by the Company”). But see, e.g., Zion Oil & Gas, Inc., Audit Committee Charter 6, QLCC Addendum, Authority, http://www.zionoil.com/company/auditcharterp.pdf (last visited Nov. 21, 2005) (stating that the QLCC “is empowered to investigate any matter brought to its attention”).

138. See Karl A. Groskaufmanis, Climbing "Up the Ladder": Corporate Counsel and the SEC’s Reporting Requirement for Lawyers, 89 Cornell L. Rev. 511, 511-12 (2004) (describing “discovery by a lawyer of credible evidence of a material violation of law by the issuer or its directors, officers or employees” as “an extraordinary event”).

139. Karl Groskaufmanis, examining the incidence of reporting under Section 10A of the Securities Exchange Act, discovered only twenty-nine reports of violations filed over nearly an eight-year period. Id. at 521.


141. For a review of the literature on social reasons, see Frances J. Milliken et al., An Exploratory Study of Employee Silence: Issues that Employees Don’t Communicate Upward and Why, 40 J. Mgmt. Studs. 6 (2003).

142. See infra notes 236-43 and accompanying text.
Presuming that lawyers have antipathy to hierarchy and wish to challenge their places in it is a comforting but unrealistic idyll. In this prediction of lawyer behavior, the QLCC is presented as disrupting the forces that lead attorneys to be subservient to managerial choices, rather than independent. These forces not only exist; attorneys also understand them to be legitimate. Attorneys operate within an ideology of managerial power. The power of corporations over their lawyers, as well as the personal ties and shared orientations that develop between lawyers and corporate leaders, lead to lawyers developing corporate perspectives. Given these isomorphisms, "it would seem unlikely that experienced lawyers with seasoned judgment will regard this opportunity to bypass the CLO and report directly to a board committee to be appealing, absent the rare case where the CLO is the violator."

Several lawyers interviewed and others have suggested that QLCCs will not spread until the SEC mandates "reporting out" or "noisy withdrawals." As one lawyer said, "absent this requirement, there is no significant fear in the corporate community that there will be lawyers voluntarily reporting out their companies." Behind this prediction is the presumption that processes currently exist to manage conflicts when lawyers gain evidence of material violations. The introduction of QLCCs does not affect these processes.

Lawyers predict that, as a result of imposing whistle-blower obligations on lawyers, clients will tell lawyers less, thereby undermining lawyers' ability to act as gatekeepers. This prediction is the knee-jerk response by lawyers to any narrowing of the attorney-client privilege. When not decrying the imposition of responsibilities on them, however, at least at one conference, lawyers "generally dismissed the chilling effect on the client/counsel relationship. The tension between being a business enabler and a policeman has existed for years, and is familiar to any reputable counsel." To presume that managers will withhold is to presume that managers understand themselves as unjustified law breakers. It is exceptional, not routine, for managers to so understand their actions. And, in those situations, one assumes they have always been careful about

146. See, e.g., Felix J. Bronstein, Note, The Lawyer as Director of the Corporate Client in the Wake of Sarbanes-Oxley, 23 J.L. & Com. 53, 64 n.85 (2003) (citing sources that discuss the chilling effect that reporting-out and noisy withdrawal rules would have on attorney-client communications); Fisch & Rosen, supra note 24, at 1130; Darlene M. Robertson & Anthony A. Tortora, Reporting Requirements for Lawyers Under Sarbanes-Oxley: Has Congress Really Changed Anything?, 16 Geo. J. Legal Ethics 785, 797 (2003); see also Howard Stock, S-O's Lawyer Rule May Chill Information Flow, Investor Relations Bus., Aug. 18, 2003 ("[A] recent survey by the International Bar Association found that some 90% of corporate lawyers expect the requirement to 'report up the ladder' any violations they discover will cause executives to withhold vital information.").
what they disclosed. Much more common is a managerial response that whistle-blowing provisions of SOX have had no effect on the client/counsel relation or, if it has an effect, that that effect is positive.149

Those who resist QLCCs depict them as something other than fire alarms. Jill Fisch and Kenneth Rosen compare the QLCC to an audit committee.150 The comparison is inapt. Regularly, financial reports need approval by the audit committee. Audit committees have an increasingly large number of tasks that must be performed on at least an annual basis. By contrast, the QLCC has nothing to do until a report by an attorney is made.151 Professors Geoffrey Hazard and Edward Rock implicitly compare a QLCC to a special litigation committee. This comparison is apt, as both are crisis management devices. But as the focus of Hazard and Rock’s argument is that the board needs on a continuing basis its own lawyer,152 this may leave the impression that QLCCs will produce work on a regular basis.

The conception of QLCCs as routinely having work assumes that QLCCs will have inappropriate work. Resisters to QLCCs presume that QLCCs will involve the board in matters that could be handled at lower levels. The QLCC’s work, it is argued, is largely work that ought to be settled by managers, including the CLO. For example, one lawyer interviewed said that “every Tom, Dick and Harry will be calling a board committee [the QLCC] directly . . . without that legal issue being properly vetted by management and going up the chain.” Another lawyer described going to the QLCC as “the most serious response” a lawyer can make, and described attorneys going to the QLCC as having “actually responded with a greater magnitude than necessary.” The same thought is also expressed in terms of protecting the directors. The ACC objected to the ability of lawyers to make reports directly to the QLCC, stating as follows:

Given the additional pressures that many directors face in the post-Enron world, we believe that . . . [reserving] the time, resources and attention of this board-level committee for those matters that either have been vetted by the CLO or may involve inappropriate activity amongst the company’s

149. See, e.g., Ass’n of Corp. Counsel Survey, supra note 111, at 6 (stating that less than twelve percent of directors reported a chilling effect and, of those so reporting, only one in five reported a negative effect for corporate governance).

150. Fisch & Rosen, supra note 24, at 1136, 1137 & n.152.

151. A QLCC would be better compared to the “monitoring board.” “Even defenders of the monitoring board acknowledge that monitoring is properly characterized as a safety valve for crisis situations. . . . The need to employ this safety valve is rare, however. Any particular company confronts crisis with limited frequency.” Jill E. Fisch, Taking Boards Seriously, 19 Cardozo L. Rev. 265, 282 (1997).

152. See Geoffrey C. Hazard, Jr. & Edward B. Rock, A New Player in the Boardroom: The Emergence of the Independent Directors’ Counsel, 59 Bus. Law. 1389, 1389 (2004) (predicting that, “with the additional legal requirement imposed on independent directors by the Sarbanes Oxley Act and related changes to SEC rules and Stock Exchange listing requirements, the independent directors, especially those on the Audit Committee, will begin to be represented on a continuing basis by independent legal counsel”).
top legal leaders... would be an incredibly important service to directors.153

Reflecting the idea that resolving legal compliance issues is work that should be done by management, not the board, various lawyers criticize the intra-organizational effect of QLCCs. One lawyer concluded that a QLCC would interfere with "reporting relationships." Another lawyer said that a QLCC "clouds the organizational chart." Similarly, another described the QLCC as "an additional level of board bureaucracy." A CLO put it succinctly: "The QLCC will take a chunk out of my budget." Because the QLCC is doing managerial work, resisters argue, its costs will be charged back to management.

It is also argued that the inappropriateness of the board's involvement in legal compliance is buttressed by the speed with which corporations are now forced to file reports. Ironically, while attempting to ensure greater board involvement in compliance, the SEC also "has shortened the reporting deadlines for an issuer's quarterly and annual reports."154 Involving the board through the adoption of QLCCs could delay the transmittal of required filings, thereby "possibly diminishing the company's market capitalization and endangering the issuer's exchange listing."155

Sometimes, the argument that board involvement in compliance is inappropriate is expressed by making puzzling predictions about behavior. The repeated predictions that lawyers will become loose cannons and that managers will become tight-lipped have already been discussed. The ACC also predicted that outside counsel retained by a QLCC would act "like the proverbial bull in the china shop."156 Why would such clumsy lawyers be hired? Surely there are some corporate lawyers who are cognizant of the intra-organizational effects of their involvement. One interviewed lawyer predicted that the option of making a report to a QLCC would prevent subordinates from engaging in conflict with superiors. This lawyer is certainly correct that learning to engage in such conflict is necessary for an

153. Apr. 7 Letter, supra note 140.
154. Groskaufmanis, supra note 138, at 524 (citations omitted).
155. Id. Conversely, it has been argued that companies might want to form QLCCs because audit committees have significantly increased workloads as a result of SOX, and might need the help, particularly on securities disclosure matters that are not specifically related to finance. The recently adopted changes to Form 8-K require companies to make current reports on a greater number of events, in a shorter period of time, and contain a number of disclosure items that are not strictly financial in nature.

156. Apr. 7 Letter, supra note 140. The American Corporate Counsel Association ("ACCA") suggested that outside counsel do not have sufficient "commitment to working sensitively and productively with managers" and may in fact "inappropriately disrupt the ongoing business of the organization, or permanently burn bridges." Id.
organization, but he had no basis for his prediction. Executives routinely work with lawyers, jointly making decisions about compliance issues. But the Business Roundtable predicts that directors, “even those with independent legal advice, will not [be able] to make the legal judgments required of a QLCC.”

There is also the prediction that a QLCC will overly rely on outside consultants, failing to engage management and the knowledge they possess. This prediction presumes that directors will make decisions lacking necessary information. The possibility that directors, concerned about their own liability, would make decisions on grounds different than the grounds on which executives would base their decisions is discussed in the next section. Here, this prediction has been analyzed only for its presumption that the board should not be involved in legal compliance decisions because they would make them inappropriately.

Resistance to the QLCC may be understood as resistance to a monitoring board. Through the regulations adopted pursuant to SOX, the SEC sought to “implement a ‘judgmental monitoring model’ of board governance in which outside directors are expected to keep a sharply skeptical eye on managers.” The QLCC is one of these mechanisms, but it is not required. It is not adopted because executives and directors have no interest in adding a new monitor. Or as an interviewed lawyer quipped, “the carrot” of the QLCC “isn’t worth the stick.”

On the other hand, a QLCC may be seen as a vehicle for the development of a “deepening reciprocal sense of both personal and professional trust, confidence and respect” between CLOs and the board. A report to the

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157. After considering the potential costs of a reporting attorney’s going to the board, the interviewed lawyer became less certain of his prediction, but he nonetheless said that the presence of the option would defeat important intra-organizational reporting structures.


159. See Apr. 7 Letter, supra note 140. The ACCA stated as follows:

In light of current events, boards are more likely than ever to forego additional consultation with company executives and staff, including existing company lawyers, in favor of retaining independent advisors to consult on virtually every aspect of the company’s governance and compliance agenda. While in many cases, hiring outside advisors is most prudent, the practice has become almost mandatory even when no suspicion of executive incompetence or malfeasance exists: in today’s climate, retaining outside advisors is considered necessary “cover” for directors concerned with their own liabilities and possible hindsight judgments made by shareholders and other stakeholders.

Id. at n.6.

160. Through SOX, “Congress quite clearly sought to force firms to adopt a different model of corporate governance in which independent directors will intrusively monitor managers.” Hazard & Rock, supra note 152, at 1412.

161. Id. at 1396.

QLCC threatens that trust. But it also provides an occasion for securing that trust by enabling the CLO to strategize with and seek the counsel of directors. The ACC suggested that the SEC needed to revise its model of the QLCC "to promote a more cooperative and less adversarial relationship between the QLCC and the CLO."164 A "prerequisite for an effective board" is a "culture of openness and constructive dialogue in an environment of trust and mutual respect."165 In an effective board, a QLCC would turn a crisis into a planning event.166

Of course, the proper attitude of the QLCC to the CLO, whether it be skeptical or trusting, depends on the case before it.167 The relationship between directors and managers needs to be both controlling and collaborative.168 Board effectiveness depends on "constructive tension" between the board and executives.169

Relationship Between Chairmen and Chief Executives: Competitive or Complementary Roles, 32 Long Range Plan. 36, 46 (1999)).

163. The Cheek Report notes that "there are situations in which separate counsel" hired by the board "may be necessary or desirable," but that as a general practice using outside counsel is not advisable because, "[a]part from the added cost of additional counsel, the division of management and the board of directors into two separately counseled factions may result in less open communication, less constructive collaboration ... and, ultimately, less effective oversight by the board . . . ." Cheek Report, supra note 14, at 24 n.54.

164. Apr. 7 Letter, supra note 140.


166. See Developments in the Law: Corporations and Society, 117 Harv. L. Rev. 2169, 2184-85 (2004) (distinguishing between "helping to guide the corporation's long-term strategy" and "'[n]egotiating' . . . in an open (and, ideally, somewhat rigorous) negotiation with management, serving as the nonconflicted representative of the company's interests").

167. See Beyond Agency Conceptions, supra note 162, at S8, S9, S18-S22; see also David A. Nadler, Building Better Boards, Harv. Bus. Rev., May 2004, at 102. There is a debate in the literature about the proper relationship of the board and management. All reject a passive board. But some depict a proper board's relation to management as one of skepticism, and others as that of defeasible trust. Those who support the skeptical board point to the problems of faulty attribution, groupthink, and other cognitive biases that may emerge through collaboration. Those who oppose the skeptical board point to the ill consequences of distrust, which impede information flow, promote myopic behavior, and degrade motivation. This debate is unproductive, as a board must sometimes adopt one attitude over another. The problem that boards encounter is that they tend to get locked into cycles that foster either control or collaboration. Chamu Sundaramurthy & Marianne Lewis, Control and Collaboration: Paradoxes of Governance, 28 Acad. of Mgmt. Rev. 397, 399 (2003). Research ought to focus on mechanisms to break up these cycles. For a review of the empirical literature attempting to measure corporate governance structures' effects on performance, see M. Andrew Fields & Phyliss Y. Keys, The Emergence of Corporate Governance from Wall St. to Main St.: Outside Directors, Board Diversity, Earnings Management, and Managerial Incentives to Bear Risk, 38 Fin. Rev. 1 (2003); Benjamin Hermelin & Michael Weisbach, Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature, 9 Econ. Pol'y Rev. 7 (2003). These studies produce no strong correlations, because financial performance will sometimes require the board to be controlling and sometimes collaborative.


169. Weil, Gotshal & Manges LLP, supra note 64, at 1.
The stakes in this "tension" are significant for CLOs and are only increasing. An Altman Weil 2003 survey commissioned by the ACC found that 39.2% of CLOs report directly to the Chairman of the Board. CLOs are told that developing "Trusting And Effective Working Relationships With The Board Of Directors" is critical to their success. One survey found that one-third of directors responded that CLOs make regular reports on legal or compliance activities to the board in executive session. Although boards do not have the formal power to fire CLOs, it is naive for CLOs to ignore the importance of their favor.

Furthermore, the diffusion of QLCCs comes at a time when boards are increasingly dependent on CLOs. The jurisdiction of the legal department is increasing. As legal compliance is perceived to be more critical to the organization, the board's need to both trust and monitor the CLO increases.

In this context, CLOs should have an interest in developing a non-adversarial QLCC. The board, too, should have an interest in forming a QLCC that has a constructive working relationship with the CLO.

If the general counsel is trusted, but attorneys make more reports to a QLCC than I predict or the evidence suggests, the board members on a QLCC can nevertheless remain relatively inactive, except when the CLO is charged. "If the board, and the members of a QLCC have confidence in the judgment and independence of the general counsel's office," the general counsel can have significant control over how a QLCC functions and much of its work "can be delegated to the general counsel." Except when the legal department itself is involved, the QLCC's investigation "may [be conducted] . . . by the chief legal officer." The QLCC may involve

170. Ass'n of Corp. Counsel, supra note 125, at 9-10.
171. Nowlan, supra note 124, at 51.
173. David Boies suggests that the QLCC should have the responsibility to "supervise, rotate and hire the general counsel." David Boies, Integrity in the Capital Markets, 28 Nova L. Rev. 261, 275 (2004); see 15 U.S.C.A. § 78j-1(m)(2) (West 2005) (giving the audit committee power to fire the independent auditor). My colleague William Widen suggests that, to enable their independence, CLOs should have golden parachutes.
174. Michael Tankersley, Implementing Attorney Ethics Policies in Law Firms and Corporate Law Departments After Sarbanes-Oxley (Part 2 with Hypotheticals and Forms), 50 Pract. Law. 39, 44 (2004). Under these circumstances, the general counsel's office would field initial reports, make initial determinations of the degree of response that is due, and then confirm those judgments periodically with the responsible board committee. When more serious and credible allegations are received, the charter would contemplate the involvement of the QLCC on a more real-time basis.
175. 17 C.F.R. § 205.2(k)(3)(ii)(B) (2005); see Petroleum Develop. Corp. QLCC Procedures 3(b), http://www.petd.com/ ("The QLCC may select internal counsel or engage outside counsel . . . to assist in the analysis and assessment of the report . . . "). At Digimarc Corp., which has a QLCC, "$b[ased on the nature of the suspected violation and the issue raised," all reports of suspected violations are referred to the appropriate division of the company or to "outside entities" for investigation. Digimarc Corp., Proxy Statement (Schedule 14A), at E-11 (Apr. 1, 2004), available at http://www.sec.gov/Archives/edgar/data/1089443/000104746904010291/0001047469-04- 010291.txt. Its Procedures for Reporting Suspected Noncompliance by Employees of Digimarc Corporation states that employees are to go to the board only if their supervisor,
inside counsel as active participants. At least one corporation has made the CLO the secretary of the QLCC. Thus, QLCC action often can be limited to the involvement of lawyers, without requiring involvement of the directors.

A trusted CLO who seeks to maintain her own power has reason to be proactive and work for the formation of a QLCC. Legal issues are already in front of boards, and a significant number of boards already hire their own lawyers, bypassing the legal department. To prevent being bypassed even more, legal departments need to know when legal issues arise. With notice, it can be the CLO who brings outside counsel to address the board.

A QLCC can be useful in bringing the CLO into the loop. In the absence of an alleged breach by the CLO, the first thing that the QLCC will do is “[t]o inform the issuer’s chief legal officer . . . of any report.” The CLO then can influence how the QLCC proceeds. As lawyers who wish to be

the CEO, or CLO “is involved in the suspected violation[s].” Id. at F-12. The company’s Code of Legal and Ethical Conduct says that “[c]ompany attorneys, under the explicit direction of the Chief Legal Officer, are responsible for conducting, at the request of management or on their own initiative, such audits and investigations as may be necessary under this policy.” Id. at F-4.

176. At Scientific Games Corp., the Compliance Committee serves as the QLCC. The Compliance Committee’s agenda is determined by the Committee Chair in consultation with the VP-Chief Legal Counsel, Compliance and VP-Security and Compliance (“Compliance Officers”). . . . While the Compliance Officers do not belong to the Committee, they attend Committee meetings . . . are responsible for preparing information . . . and respond to questions . . . . The General Counsel or another company attorney may serve as counsel to the Committee at the Committee’s discretion.


177. At Intermune, Inc., a Compliance/QLCC Committee was formed. Its charter states that “[t]he Secretary of the Company shall be the Secretary of the Committee. The Secretary shall keep minutes and records of all meetings of the Committee.” Intermune, Inc., Charter of the Compliance/Qualified Legal Compliance Committee of the Board of Directors (2004), available at http://www.intermune.com/pdf/charter_compliance.pdf. At Intermune, the General Counsel is also the Corporate Secretary. See Intermune Inc., Executive Management Team, http://www.intermune.com/wt/itmn/management_team (last visited Oct. 31, 2005).

178. See Ass’n Corp. Counsel Survey, supra note 111, at 7 (stating that thirty percent of directors reported that their boards or committees have done so).

179. Jeffrey Kindler, CLO of Pfizer, reported as follows:

I’ve been proactive about this . . . . I have found it helpful to bring outside counsel into audit committee meetings when particularly important or difficult issues are presented. They appreciate that, and I certainly appreciate it . . . . I don’t think it would be a good thing if the audit committee felt it needed regular outside counsel representation . . . . if the committee got to the point where they asked for that, it would probably indicate a problem.

The Roundtable, supra note 98, at 48.


181. Id. § 205.2(k)(3)(ii); see also Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296, 6309 (Feb. 6, 2003) (final rule) (“Under this alternative, the QLCC . . . would be responsible for carrying out the steps required by Section 307 of the Act: notifying the CLO of the report of evidence of a material violation (except where such notification would have been excused as futile under section 205.3(b)(4)).”).
heard by the board likely will be able to get a hearing, CLOs should prefer that such a lawyer go to the QLCC so that the CLO will be apprised of the problem.

CLOs also can use QLCCs to gain control over work. Johnson Controls has instituted a system in which the legal department issues quarterly reports about "anything that might trigger an investigation; or an environmental concern, regardless of size or location."\textsuperscript{182} Johnson Control's general counsel explained that they tried to monitor "[a]nything that potentially is a public relations issue. Even if it's small dollars, if it could hit the press, we need to see it," and then it is reported.\textsuperscript{183} These reports are "vehicles for raising issues worldwide and getting them into the system\textsuperscript{184}—that is, for getting the issues under the control of the CLO. Johnson Controls is the only company of which I am aware that has matters pending before the QLCC. The CLO reports that there are "three 'up the ladder' matters pending which have been referred to the company's QLCC";\textsuperscript{185} that is, there are three matters where the CLO's authority is being contested and the CLO has referred them to the QLCC.

A general counsel also can use a QLCC as a back stop. That a QLCC exists is useful for a CLO when the CLO loses a political battle within management. It is difficult for a CLO to attain and maintain the intra-corporate power necessary to stop a pet project of senior management or a project in which there have been substantial investments, or to demand that the corporation make significant expenditures for legal compliance.\textsuperscript{186} Directors understand that such situations will occur,\textsuperscript{187} and CLOs have gone to the board in such situations.\textsuperscript{188} Being placed on the board's agenda, however, entails further political battles and can itself be costly, especially if the CEO doesn't want the board to get involved.\textsuperscript{189} A CLO's

\textsuperscript{182} Foley & Lardner LLP, \textit{supra} note 80, at 4 (quoting Jerome D. Okarma, General Counsel, Johnson Controls, Inc.).
\textsuperscript{183} Id.
\textsuperscript{184} Id.
\textsuperscript{185} Id.
\textsuperscript{187} In one survey, almost three-fourths of directors reported that the CLO should go to the board, even without the concurrence of the CEO "[w]hen an allegation has not been addressed by senior management after repeated attempts to get them to act." Ass'n Corp. Counsel Survey, \textit{supra} note 111, at 5.

\textsuperscript{188} "When asked whether they had ever been involved in a situation in which a general counsel had taken a matter to the board without the consent of the CEO, 10 percent of corporate directors and 17 percent of general counsel responded yes." Krebs & Raber, \textit{supra} note 131, at 95. "Of those who responded yes, 81 percent of corporate directors and 75 percent of general counsel say that bypassing the CEO resulted in the appropriate outcome." Id.

\textsuperscript{189} One interviewed lawyer suggested that there is no need for a QLCC because "post-Enron... it is inconceivable that a board committee would sit on a complaint [from a CLO] and not act appropriately." If true, the presence of a QLCC can generate compliance even if it is not used. Using the QLCC could be costly to a CLO: As one lawyer noted, "'How many times can the general counsel go around the CEO and straight to the board with a disclosure?' The answer is, 'Once. Because the CEO will fire you.'" \textit{Lessons from Enron}:
ready access to a QLCC, even if not used, can be useful to CLOs in intra
corporate warfare.

If the board trusts the CLO, QLCCs can be used to deepen that trust. Trust is variable, but properly managed QLCCs benefit CLOs who have not abused that trust. Yet CLOs oppose their adoption. Are so few CLOs trusted by their boards?

CLOs who have the board’s trust can benefit from the adoption of QLCCs, but nevertheless do not support them. In an interview, one said simply, “I’d resign if they created a QLCC.” That CLO explained that, even though he was trusted, the adoption of a QLCC would show that he was not trusted. Another put it this way: “It’s my job to convince management to do the right thing. That’s what I get paid for and if I can’t do it then I should focus on taking a position in a different company.”

The adoption of QLCCs challenges that CLOs “get paid for” making the difficult and messy legal compliance decisions. Both inside and outside counsel understand that the CLO makes and assumes responsibility for legal compliance decisions. The job of the CLO is “to handle the most sensitive issues of legal compliance the company faces.”\textsuperscript{190} QLCCs are inappropriate because “both management and directors . . . believe that investigating the reports and developing a response should, in most instances, be the responsibility of management.”\textsuperscript{191} In fact, “most in-house lawyers have spent significant amounts of time and energy encouraging the board to trust them to handle [inside the legal department] these issues.”\textsuperscript{192} As one outside counsel interviewed reported, “It is the job of the general counsel to stand there at the coalface. That’s not a job for the board. A general counsel who lets the board create a QLCC doesn’t deserve the money he’s being paid.” Standing at the coalface, the CLO is at the cutting edge. Standing at the coalface, the CLO gets dirty.

The resistance to QLCCs derives from understandings that the board is an illegitimate forum for cutting legal coal. Directors are not understood to be part of the “systems of jobs” through which legal compliance decisions are made. It is true and explanatory that a QLCC poses “an out-group threat, to be resisted and circumvented as inconsistent with group solidarity and the primary mission of the business as understood” by the executives.\textsuperscript{193} But characterizing QLCCs as a threat mischaracterizes the lawyers’ points of view. Why, when a QLCC can give lawyers greater access to the board and support lawyers in conflicts with management, do

\textsuperscript{A Symposium on Corporate Governance, 54 Mercer L. Rev. 683, 720 (2003) (comment of William Ide).}
\textsuperscript{190. Linda Madrid, US Counsel Come to Grips with Reporting Rule Confusion, 23 Int’l Fin. L. Rev. 39, 40-41 (2004).}
\textsuperscript{192. Foley & Lardner LLP, supra note 80, at 8 (quoting Susan Hackett, General Counsel, Association of Corporate Counsel).}
\textsuperscript{193. Donald C. Langevoort, The Epistemology of Corporate-Securities Lawyering: Beliefs, Biases and Organizational Behavior, 63 Brook. L. Rev. 629, 673 (1997).}
lawyers not want to take advantage of this out-group threat to the executives with whom they work?

Lawyers, both inside and outside counsel, do not want the power QLCCs might afford them because board involvement in legal compliance decisions is inappropriate given that the CLO has assumed responsibility for these decisions. As the ACC put it, what a QLCC does is "to ‘absolve’ the company’s lawyers of responsibility."\textsuperscript{194} Susan Hackett explains that many CLOs did not present the possibility of forming a QLCC to the board because they “were not comfortable telling the directors to ‘Remove me from responsibility.’”\textsuperscript{195} Standing at the coalface is the job of the CLO. If it requires absolution, the CLO must resolve this personally. The CLO is the "fall guy" when things go wrong. In other words, the CLO is the vice-president in charge of going to jail.\textsuperscript{196}

The ACC advises newly appointed CLOs that they must “Be Willing to Assume Risk.”\textsuperscript{197} A CLO “not only gives legal advice but also shares in the management responsibility for decisions. Such willingness to assume reasonable risks establishes the lawyer as part of the business team and not simply as a legal consultant.”\textsuperscript{198} Consequently, what is observed is that "in-house counsel often sought out opportunities to act as principal: leading corporate transactions, making business judgments, and taking on expanded corporate responsibilities."\textsuperscript{199}

It is essential for lawyers that there be "ways of achieving a modus vivendi with their employing organization which prevents them from experiencing high and intolerably stressful levels" of conflict between their professional and organizational selves.\textsuperscript{200} For both inside and outside counsel, placing the CLO at the coalface manages this conflict. Compliance decisions are inappropriate for the board because, although they are business decisions, they also are professional judgments, and they also are personal choices. The CLO has vested his or her integrity in these decisions.\textsuperscript{201} Of course, all hope that the CLO’s stake will not have to be cashed out.

The lack of diffusion of QLCCs demonstrates a source of resistance that is not captured by agency cost analysis. Agency cost theorizes an agent playing a role in which the agent may use the role’s authority for the

\textsuperscript{194} Romanek & Winer, \textit{supra} note 191, 54 app. (ACCA’S Practical Tips for Dealing with the New Attorney Responsibility Standards Under the Sarbanes-Oxley Act, Tip #3). This question is also asked in Hackett, \textit{supra} note 119, at 24.
\textsuperscript{195} Foley & Lardner LLP, \textit{supra} note 80, at 8.
\textsuperscript{196} Robert Jackall, \textit{Moral Mazes} 21 (1986).
\textsuperscript{197} Ass’n of Corp. Counsel, \textit{supra} note 125, at 20.
\textsuperscript{198} \textit{Id.}
\textsuperscript{199} Randy S. Segal & Richard K.A. Becker, \textit{Through the Looking Glass: Ten Lessons from In-House Counsel on Trial}, ACC Docket, May 2004, at 23, 36.
\textsuperscript{201} For a discussion of the important role that integrity plays in executive decision-making, see Chester I. Barnard, \textit{The Functions of Executive} (1968).
RESISTANCES TO REFORMING

agent's own interests. In regards to QLCCs, agency cost analysis would suggest that CLOs may cheat (by not informing boards of the option of QLCC adoption in order to maintain the CLO's power or to protect top management law breakers) or shirk (by counseling boards to adopt QLCCs to enable the CLO to foist problems away from him and onto the board). The resistance described here also derives from the legitimate authority the agents possess. But it does not derive from agents playing a role separate from their self understandings and interests.

Rather than a disenchanted, organizational cage, the ideology of managerialism represents a triumph of spirit over calculative rationality. An organization is not simply a production system, it is also a social system that is shaped by an environment which in turn shapes the organization. As a consequence, corporate hierarchies contain within themselves "[r]omantic fictions of personal fulfillment, development, and growth." The corporation may be a nexus of contracts. But some of these contracts are symbolic. Corporations are run by committed professionals who demand control "as an outcome of [professional] identity rather than an effect of the pure motivating power of instrumental and hedonistic sources of gratification . . . feelings of personal worth and identity become closely tied to the indications proved by these systems." The ideology of managerialism is a form of governmentality. It is imbedded in a web of routine practices and understandings that go unnoticed. It allows corporate agents to construct themselves by providing motives, constraints, and satisfactions.

Legal compliance decisions require selecting options and attendant risks. Identifying legal risks requires understanding "Who is potentially affected by what the business does? Who are the stakeholders? What are the potential risk areas in respect of each of those parties?" Needing to reach

\[202\] The CLO's deliberate failure to counsel use of the QLCC constitutes "cheating the corporation," of course, only if it is assumed that on balance the QLCC operates to the corporation's benefit.

\[203\] According to this agency cost analysis, the observed lack of diffusion of QLCCs would suggest that CLOs are more ambitious—seeking to attain and maintain power—than anxious—worried about the effects of resolving problems themselves.

\[204\] Robert Dingwall & Kerry Kidd, After the Fall . . . : Capitulating to the Routine inProfessional Work, 108 Penn St. L. Rev. 67, 84 (2003).

\[205\] See Langevoort, supra note 32, at 1193. Langevoort writes as follows:

[A] divide exists—though many contemporary theorists are working to bridge it—about whether it makes sense to think about the firm as a complex connection of people and contracts or whether we should go a step further and acknowledge that organizations take on an internal life of their own, separate and distinct from the individuals who work there at any given time. If so, then norms and culture matter, too, perhaps sufficiently to substitute for strong legal controls with respect to some kinds of incentives.

\[206\] Id.

\[207\] Caron Murphy, Balancing the Risks, European Counsel, June/July 2002, at 63, 66. From a company perspective, by contrast, it may be said that legal risks are managed by avoiding, assuming, controlling, reducing, transferring, and/or mitigating them.
compromises between the different stakeholders, legal managers define who and what is the client. To them, legal compliance decisions are made by moral analysis. But it is a particular form of moral analysis. It is one tied to the virtue of the CLO.

In selecting options and choosing risks, executives perceive their interests as textured by those of the corporation’s stakeholders. Management, not the board, is the nexus of contacts between the corporation and regulators, creditors, employees, public interest organizations, and other stakeholders. Management, not the board of directors, perceives itself as the “mediating hierarch” between the company’s stakeholders. The diffusion of QLCCs reveals that, at least for legal compliance decisions, executives are unlikely to use the board to “kick ‘upstairs’” difficult issues.

When lawyers also wear management hats, they become personally liable for breaches of fiduciary obligations to the corporation. “In-house lawyers are only effective if they are integrated and trusted members of corporate executive, strategic and compliance management teams,” says the President of the ACC. Hence, they are treated as principals. Post-SOX, more inside counsel are becoming compliance officers or leaders of a compliance management group. These jobs are understood by regulators to be business related, not legal. In the ideology of managerialism, they are understood as other ways to incur personal risk.

The recent SEC action against the general counsel of Electro Scientific Industries, Inc., depicts this shift in understanding of the role of the CLO. The general counsel was “not involved, present, or consulted” when the CFO made the noncompliance decision. The CLO allowed the CFO, who was to be promoted to CEO, to cut him off at an audit committee meeting. As a result, the committee was not presented with information contained in a memorandum that revealed noncompliance, and was material to the corporation’s 10-Q filing.

The complaint alleged the general counsel’s “failure to fulfill his gatekeeper role.” The complaint alleged that he had a duty to inform the


211. Madrid, supra note 190, at 41.

212. See Ass’n of Corp. Counsel, New to In-house Practice 31-32 (2004).


214. Id. at 5.

215. Id. at 4.

216. Id. at 1.
board which he breached.217 The case settled on a different theory. The
general counsel accepted personal liability for making a corporate decision
because he “decided” not to pursue matters with the board.218

The SEC continued this approach when investigating Google’s general
counsel, David Drummond. Before its initial public offering (“IPO”),
Google granted options to its employees. “By failing to inform the board
that there was a legal issue as to whether registration of the stock options
granted to employees was required, Drummond took responsibility for the
decision,” SEC enforcement officials are reported to have said.219 “Instead
of going to the board with the issue about registration [of the stock options],
he simply made the decision on his own . . . [Drummond] was a lawyer who
became a client.”220

“Managerialism as an ideology” needs to be distinguished from other
uses of “managerialism” in the legal literature. Some have challenged
director primacy as a normative theory of corporate organization, arguing
that law should embrace managerialism.221 Managerialism as an ideology
means that managerialism is normative for managers. From a manager’s
point of view, manager primacy is desirable. The ideology of
managerialism does not argue, however, that the law ought to embrace the
manager’s point of view. Others have described corporate behavior as
managerialist.222 Those authors have typically understood managerialism
as power, often used for self-serving ends.223 Managerialism as an
ideology emphasizes that corporate behavior is to be understood, not only
as deriving from power or interest, but also from the normative conceptions
of corporate actors.224 Managerialism as an ideology treats seriously
managers’ accounts of responsibility.

217. Id. at 6.
218. Pamela Atkins, SEC Enforcement Chiefs Warn Lawyers About Risks of Going
219. Id. at 75.
220. Id. (quoting a SEC official).
221. See, e.g., Adolf A. Berle, Jr., For Whom Corporate Managers Are Trustees: A Note,
45 Harv. L. Rev. 1365 (1932); E. Merrick Dodd, Jr., For Whom Are Corporate Managers
Trustees?, 45 Harv. L. Rev. 1145 (1932); see also William W. Bratton, Jr., The New
Economic Theory of the Firm: Critical Perspectives from History, 41 Stan. L. Rev. 1471
(1989); Allen Kaufman & Lawrence Zacharias, From Trust to Contract: The Legal
222. See, e.g., Charles M. Elson, Director Compensation and the Management-Captured
223. See Oliver E. Williamson, The Economic Institutions of Capitalism 317-22 (1985)
(discussing managerial discretion); Henry Hansmann & Reinier Kraakman, The End of
224. See Mark J. Roe, The Institutions of Corporate Governance 12-13 (Harvard John M.
http://www.law.harvard.edu/programs/olin_center. Roe writes,
Managerialism is not unproblematic. Managerial decisions sometimes need review, because managers may be on the wrong tack. Psychological biases, like “path-dependence,” may prevent course adjustments.  

The board can provide useful strategies and assessments. Managerialism as an ideology challenges none of these arguments. It is an account of individual responsibility, not one of solitary decision making.

B. Directors at the Coalface?

Corporations must publicly assert their commitments to obey the law. SOX requires corporations to promulgate codes of ethics which must mandate “compliance with applicable governmental rules and regulations.”  

The NYSE requires companies to have codes of ethics that mandate “compliance with laws, rules and regulations,” and the National Association of Securities Dealers Automated Quotation (“NASDAQ”) requires its listed companies to have codes of ethics which require that “illegal action must be dealt with swiftly and the violators reported to the appropriate authorities.” The codes of ethics that corporations promulgate normally are unflinching in demanding legal compliance. A not atypical formulation is, “Obeying the law, both in letter and in spirit, is the foundation of this Code.”

Managers do not act solely for remuneration, but also for the satisfaction of doing a good job. And “doing a good job” is defined by circumstance, psychology, and culture. . . . These notions of norms and professionalism are softer and less well understood than the other institutions, but that doesn’t mean that they’re absent, or that they’re unimportant.

Id.  

225. Langevoort, supra note 168, at 826.  


Each employee has an obligation to comply with the laws of the cities, states and countries in which Cell Genesys operates. We will not tolerate any activity that violates any laws, rules or regulations applicable to Cell Genesys. . . . You are expected to understand and comply with all laws, rules and regulations that apply to your job position.

NYSE regulations require that a listed company’s audit committee’s charter address how the committee “assist[s] board oversight of . . . the company’s compliance with legal and regulatory requirements.”\(^{230}\) As the Sherman & Stearling survey found, “[t]he audit committees of 60 of the Top 100 companies have attempted to limit the scope of this responsibility. . . .”\(^{231}\) They have attempted to limit the scope of the issues that audit committees will consider. They also have attempted to limit the reports that audit committees receive about compliance.\(^{232}\) Fifteen of the Top 100 companies include in their audit committee’s charter exculpatory language to the effect that it is “[n]ot [the] audit committee’s responsibility to ensure compliance with laws.”\(^{233}\)

The board’s aversion to oversight of legal compliance is not limited to resistance to QLCCs. Lawyers who have been rewriting audit committee charters to exclude liability for legal compliance may feel it inappropriate to propose to the board the formation of a QLCC.

The NYSE listing requirements also require audit committees to “discuss policies with respect to risk assessment and risk management.”\(^{234}\) The NYSE commentary to this rule elaborates that “it is the job of the CEO and senior management [i.e., not the board] to assess and manage the company’s exposure to risk.”\(^{235}\) With respect to risk management, unlike legal compliance, the audit committee does not have to demonstrate how its oversight assists in reducing undesirable corporate behavior.

Nevertheless, some boards and lawyers who work for boards seek clarification of this discussion requirement. What must be discussed? According to the Rules, “the [audit] committee must discuss guidelines and policies to govern the process by which risk assessment and management is undertaken.”\(^{236}\) Some lawyers and boards worry that this creates too much

\(^{230}\) NYSE Rules, supra note 227, at 10.
\(^{231}\) Shearman & Sterling LLP, supra note 43, at 20.
\(^{232}\) Id. The Shearman & Sterling Survey reported that fifty-one companies limited the scope of their compliance reports to “[d]iscuss[ion] [of] legal issues with material or significant impact on company or its financial statements”; twenty-eight companies limited the scope to “[d]iscuss[ion] [of] correspondence or report that raises issues that may have significant impact on company’s financial statements”; ten companies limited the scope to “[r]eview [of] significant litigation and related issues including risk”; and one company limited the scope to “[r]eview[ing] and discuss[ing] reports from General Counsel about legal issues determined by General Counsel to merit attention [by the] committee.” Id.
\(^{233}\) Id.
\(^{234}\) NYSE Rules, supra note 227, at 11.
\(^{235}\) Id. at 12.
\(^{236}\) Id. Susan Bies, Governor of the Federal Reserve Board, has clarified board responsibilities as follows:

Directors . . . have the responsibility to set the tone regarding their corporations’ risk-taking and to oversee the internal control processes so that they can reasonably expect that their directives will be followed. . . . Internal controls are the responsibility of line management. Line managers must determine the level of risks they need to accept to run their businesses and to assure themselves that the combination of earnings, capital, and internal controls is sufficient to compensate for the risk exposures. Supporting functions such as accounting, internal audit, risk management, credit review, compliance and legal should independently
risk of liability. One company states in its audit committee charter that "it is the responsibility of the CEO and senior management to determine the appropriate level of the Company's exposure to risk."237

Discussion of risk management entails discussion of how much risk is being hedged and how much is outstanding. That choice, as the above charter clarifies, is management's. Discussion of legal compliance also entails discussion of how noncompliance is being hedged and how much is outstanding. That choice, however, cannot be publicly admitted. Publicly, corporations are committed to complete compliance. This is a dilemma a board faces in adopting a QLCC.238

A QLCC is a one-sided ratchet. Except when it is used by the CLO,239 the QLCC will only be activated when the CLO approves of an action that an attorney reasonably believes is a violation. As the General Counsel to the ACC has observed,

In a practical world, I do not know of a single general counsel who honestly believes that they would report [their conclusion that the company is violating the law] up the ladder of their management, and even beyond their management to the board, and that any board in the Western world at this point would say to them, "We choose not to take your advice, we'd rather have an SEC investigation triggered." It's just never going to happen.240

There are three situations in which a CLO may approve an action that a lawyer believes is a violation. First, there may be situations in which there is actual legal or factual disagreement. Few of these situations are likely to reach a QLCC because they are manageable. An independent attorney, for example, can issue a report that will prompt the reporting attorney to step

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monitor the control process to ensure that they are effective and that the risks are measured appropriately.


238. Executives may point, not to corporate choice, but to the complexity of regulation as creating the dilemma. This argument has some merit: "[A]t least in some complex regulatory situations . . . it may not be possible to know for certain that one's business is in compliance or fully in compliance . . . [o]r it sometimes occurs . . . that complying with one . . . regulation actually conflicts with complying with another." Eric W. Orts, The Complexity and Legitimacy of Corporate Law, 50 Wash. & Lee L. Rev. 1565, 1603 n.196 (1993).

239. See supra notes 174-89 and accompanying text.

Second, there are situations in which the CLO is "in" on the deal. These are precisely the situations for which QLCCs are designed, especially if it is not only the CLO but also other executives who are "in" on the deal. And, third, there are situations in which a CLO approves an action, not because of improper benefits flowing to the CLO, but because of the CLO's decisions about the corporation's overall legal risk portfolio. "[T]he GC must be adept at risk management," balancing "the CEO's game plan," the business's "competitive realities," "the needs and objectives of the local management team," and the "murkiness of the law." As Caron Murphy notes, "[A] balance must be struck between legal perfection and the commercial demands of the business. . . . The key is to be realistic."

From the outside, the third situation may look like the second, because the CLO is accepting the risk of noncompliance and is being well paid by the company. Consequently, the reporting attorney may be unwilling to step down. But in the third situation, the CLO and the reporting attorney are battling about the corporation's tolerance of legal risk. They have different perspectives: The CLO is looking at the portfolio, the reporting attorney at the instant case. The SEC prevented easy resolution of this conflict when it decided to deny that the CLO's determination—even when the CLO's determination is "in the range of reasonableness"—is dispositive of an attorney's reporting obligations.

241. See 17 C.F.R. § 205.3(b)(3)(ii), (b)(8) (2005). The regulations allow a lawyer to step down when the board is advised that the CLO has hired an attorney who has determined that there is a "colorable defense" regarding the violation. Id. § 205.3(b)(6)(B)(ii). The fear of lawyers as loose cannons may stem from this language. Having raised the issue, will a lawyer who receives such a letter step down? Not likely. In reality, however, lawyers do not write such letters. If they did, any sophisticated reader would know that the letter refers to what is almost certainly a violation. For a lawyer who receives such a letter, the situation switches from the first type described in the text to the third type.

242. An attorney may go directly to the QLCC when the "attorney reasonably believes that it would be futile to report evidence of a material violation to the issuer's chief legal officer." Id. § 205.3(b)(4).

243. "[T]he scope of that risk, its wider consequences for the company, the relationship between that risk and others, and the aggregate risk being assumed by the company often are matters that only the General Counsel is in a position to assess in their entirety." Stephen J. Friedman & C. Evan Stewart, The Corporate Executive's Guide to the Role of the General Counsel 2 (2000), quoted in Beardslee, supra note 100, at 32 n.104.


245. Murphy, supra note 207, at 65.

246. In response to the rules, the ABA informed the SEC that "[w]e believe it is important that the Commission recognize that a reporting attorney may rely on the considered judgment of the CLO so long as that judgment is in the range of reasonableness even though the attorney would not necessarily come out that way." Implementation of Standards of Professional Conduct for Attorneys, 68 Fed. Reg. 6296, 6299 n.19 (Feb. 6, 2003) (final rule). The SEC rejected this argument:

While some commentators suggested that a reporting attorney should be able to rely completely on the assurance of the issuer's CLO... the Commission believes that this information, while certainly relevant to the determination whether an attorney could reasonably believe that a response was appropriate, cannot be dispositive of the issue.
QLCCs engage a risk-averseness differential between (a) lawyers or directors considering a particular risk, and (b) inside counsel—in difficult cases typically the CLO—deciding about the shape of the issuer’s portfolio of legal risks. An issuer makes multiple decisions containing legal risks. Companies develop cultures regarding the assumption of legal risks. Lawyers engage those cultures, sometimes resisting their crystallizations. Ultimately, CLOs make decisions about the kind and degree of legal risks the issuer will take in any given situation.\footnote{Normal citation} They make such decisions in the context of engagements with multiple stakeholders and in light of the issuer’s culture and portfolio of legal risks. For each legal compliance decision, the CLO’s level of risk acceptance is determined by the issuer’s various undertakings and stakeholders. In regards to a report made to a QLCC, a reporting attorney’s or a director’s level of risk acceptance will be determined from a perspective emergent from the particular report.

Normally, this risk-averseness differential is managed. The ideology of managerialism, which presumes that executives, including CLOs, make risk-bearing decisions, makes these disputes mostly manageable. When there is a risk that someone will go to jail, these disputes also are mostly manageable. Although a CLO may be the “VP in Charge of Going to Jail,” this is not a prospect that CLOs seek. The prospect that even the best laid cover-ups may be discovered will mostly make CLOs avoid actions that can land someone in jail. But sometimes there is a crisis, and a dispute between lawyers, or between lawyers and executives, cannot be contained. In a crisis, a QLCC may be roused from its dormancy.

A QLCC is asked to examine the CLO’s level of acceptable risk taking regarding a single violation. A QLCC requires directors to decide an appropriate level at which to accept noncompliance. And although they may rely on an opinion that there is a “colorable defense” for the action, directors are reluctant to do so transparently. Directors face a fundamental ambiguity in having responsibility for “legal compliance,” while facing the reality that their company accepts at least the risk of noncompliance. QLCCs make transparent that corporations take legal risks. Yet corporate legitimacy demands preventing noncompliance. From the perspective of directors, all involvements in legal compliance, and QLCCs in particular,

\footnote{Description of the process as one of the CLOs saying “we can take this much risk here and this much there” is a descriptive, but not necessarily accurate, depiction of the decision process. Corporations take action after considering the available options. It is only after such consideration that corporations determine acceptable risks. Professor Baruch Fischhoff et al. describe the limitations of the phrase “acceptable risk” as follows: Although the phrase acceptable risk is useful for describing a kind of decision-making process, it is not appropriate for describing the results of that process. The risk associated with the most acceptable option is not acceptable in any absolute sense. One accepts options, not risks, which are only one feature of options. Moreover, even the choice of an option is highly contingent on how the problem is defined, what other options are available, and who is doing the deciding. Baruch Fischhoff et al., Acceptable Risk 139 (1981).}
“create the potential for expanded board liability and increased intervention by the courts into corporate affairs.”248

Risk taking is a normal part of corporate action.249 A central character, the entrepreneur, is quite simply a risk taker.250 Corporate governance strives to sustain risk taking, as in the business judgment rule. Agents present risks of opportunistic behavior, whose costs can be minimized, but never eliminated. As William H. Simon has noted, “‘Risk management’ is a key function in the self-conscious bureaucracy. Managers are expected to identify risks, formulate strategies for limiting them, and update the strategies in the light of experience.”251

It is normal for businesspeople to understand that “law is simply a source of ‘risk’ to the business firm; it is the lawyers’ task to assess it and, to the extent possible, reduce it.”252 This is not to say that businesspeople take the “bad man’s” view of legal rules.253 To say that noncompliance is normal is not to say that corporations violate the rules whenever it is in their interest to do so. In fact, corporations may be much more compliant than one would think if one took the “bad man” perspective on corporate action. Corporations do have institutionalized commitments to compliance, such as in quality control departments. Corporations do want to be good corporate citizens. There are, in short, cultures of compliance that exert pressures upon corporate actors. Nonetheless, “[e]vidence abounds that regulatory violations by business firms are far from infrequent.”254 Despite corporate good intentions,

[c]ompanies cannot establish a general culture and belief system that emphasizes aggressiveness, risk-taking and limit-testing for general competitive purposes without running the risk that those same attitudes


249. See Thomas L. Barton et al., Making Enterprise Risk Management Pay Off 5 (2002) (“The term ‘risk’ includes any event or action that will adversely affect an organization’s ability to achieve its business objectives and execute its strategies successfully.” (internal quotations and citation omitted)).


251. Simon, supra note 33, at 22-23.


253. See id. at 1192 (discussing the proposition that a corporation’s “‘managers have no general obligation to avoid violating regulatory laws, when violations are profitable to the firm’”) (quoting Frank H. Easterbrook & Daniel R. Fischel, Antitrust Suits by Targets of Tender Offers, 80 Mich. L. Rev. 1155, 1168 n.36, 1177 n.57 (1982)); see also Donald C. Langevoort, Monitoring: The Behavioral Economics of Corporate Compliance with Law, 2002 Colum. Bus. L. Rev. 71, 79 (analyzing compliance by defining it as that which will “maximize the firm’s income over the long run”).

254. Dorothy Thornton et al., General Deterrence and Corporate Environmental Behavior, 27 Law & Pol’y 262, 264 (2005). Thornton et al. cite an Environmental Protection Agency study that found a twenty-five percent rate of noncompliance. Id. at 283 n.3.
will be invoked, and subconsciously twisted in self-serving fashion, to justify unlawful behavior.255

The risk-taking culture of executives can be constrained by the fact that executives operate within a context of contacts with diverse stakeholders. For executives, rationality consists of “informal, flexible and expedient strategies of problem-solving and crisis management based on bargaining and negotiation” between and among the relevant stakeholders.256 One particular group of contacts is with regulators. Except in times of scandal, corporations do not interact with regulatory agencies that “go by the book.” These regulatory agencies have “risk logics.”257 Together, corporations, regulators, and other stakeholders create discourses of risk logics.258 These are depoliticized discourses, where choices of the legislature are subsumed in the corporate logic of risk management.259 These discourses are potentially inclusive, however, because integrated risk management examines reactions by all stakeholders, including regulators.260

Compliance-related behavior emerges from these risk logics, rather than from either the deterrence function of legal enforcement or the expressive function of legislation.261 These logics determine which rules will be followed and where legal risks are to be taken. It is in relation to this nexus of contacts that executives identify the “efficient investment[s] in compliance.”262 This process defines the corporate “social license.”263

Companies have different risk portfolios. Some will play close to the line on environmental matters, but be “holier than thou” on financial reporting. Some may play fast and loose on labor relations, but contribute mightily to local charities. Enron, for example, was “an exemplary

259. “Acceptable-risk decisions require hard choices . . . . Congress has often passed the buck to regulators . . . . Congress must clearly state what it believes the will of the people to be. That goal is not achieved by mandating unrealistic standards like zero risk.” Fischhoff et al., supra note 247, at 153. My colleague Patrick Gudridge suggests that I am consequently describing second-order risk management whose presence should influence first-order decision making.
260. See, e.g., Thomas Barton et al., supra note 249, at 198-212; Fischhoff et al., supra note 247, at 142-44.
262. Williams, supra note 248, at 1293.
263. Neil Gunningham et al., Social License and Environmental Protection: Why Businesses Go Beyond Compliance, 29 Law & Soc. Inquiry 307, 307 (2004). Gunningham et al. assert that the social license is based upon the expectations of “local communities, the wider society, and various constituent groups.” Id. at 313.
corporate citizen. . . . [Corporations] are rarely as consistently virtuous or corrupt as the media portrays them. Corporations are complex institutions and they are subject to a wide variety of pressures.\textsuperscript{264} The pressures shape the risk portfolios that different corporations carry.\textsuperscript{265}

Constructing legal compliance by risk logics that emerge from a process shaped by a company’s nexus of contacts and the pressures negotiated therein suffers from two basic problems. First, the risk logics are unaccountable. They make power, but they do not reveal it.\textsuperscript{266} They generate decisions that are shaped and justified by process: They incorporate stakeholders. They are not justified by publicized substantive choices.\textsuperscript{267} Second, the management of legal risks is improperly organized, and therefore the risk logics do not provide constraints.

It is a basic principle of risk management that those who originate and manage risks should not be the ones who set risk policy and monitor compliance with that policy.\textsuperscript{268} A salesman paid on commission is a poor choice for determining customer creditworthiness. In most corporate functions “key monitoring and even evaluation functions are more likely to be performed by people who have no strong personal contact with the person monitored or evaluated.”\textsuperscript{269}

The legal department manages legal risk, sets legal risk policy, and monitors compliance with that policy. As lawyers join project teams, it also may be said that they originate the legal risks.

Consider a report on British Telecom (“BT”):

[B]efore privatization . . . no level of [legal and regulatory] risk was acceptable. . . . BT is now a player in one of the world’s fastest moving and most competitive markets . . . [which] does not give the company the luxury of spending hours ensuring that all possible legal and regulatory risks have been eliminated . . . . Lawyers in the team are expected to be as commercial as the customers they advise and to feed the risk assessment into the overall business decision . . . . In these circumstances, there can


\textsuperscript{265} This discussion has assumed that corporations are internally organized to carry out executive decisions. Of course, that need not be the case. For a discussion of how peering inside the black box of the firm complicates regulation, see Timothy F. Malloy, \textit{Regulation, Compliance and the Firm}, 76 Temp. L. Rev. 451 (2003).

\textsuperscript{266} See Richard L. Abel, \textit{Risk as an Arena of Political Struggle}, 83 Mich. L. Rev. 772, 783 (1985). Abel notes that although the regulatory regime was enacted by Congress, Bardach and Kagan argue that it does not deserve respect because it deviates from “norms of social responsibility”—although once again they offer no evidence for the content of these norms, who holds them, or how they deviate from the regulations.

\textit{id.}

\textsuperscript{267} See Heydebrand, \textit{supra} note 256 (criticizing regulation through informal, negotiated processes).

\textsuperscript{268} See, \textit{e.g.}, Kevin S. Buehler & Gunnar Pritsch, Running with Risk: McKinsey on Finance 7, 9 (2004).

\textsuperscript{269} Simon, \textit{supra} note 33, at 22; \textit{see also id.} at 23-24.
be no official "risk threshold". The level of risk is assessed on a case by case basis.\textsuperscript{270}

Because legal departments both define and manage risk, the commitments made to other stakeholders may be undone by the interests of those who manage the risks. Like all of us, inside counsel may be swayed by more immediate concerns. They need to be monitored for compliance with the risk policies that are being set by the negotiations among all the stakeholders.

A QLCC offers the potential for creating the essential separation needed for risk management. The legal department would manage the legal risks, and the board would set the appropriate levels of compliance and oversee internal control processes that monitor whether those levels are being adhered to. Realizing this potential may be understood as simply implementing the appropriate "substantive role of the board."\textsuperscript{271} There are two difficulties, however, with realizing this potential. First, directors are not engaged in the nexus of contacts between the corporation's stakeholders. They cannot function as mediating hierarchs. Second, the QLCC would make the board accountable for noncompliance.

Executives, unlike board members, are entangled in a web of relations with corporate stakeholders. They are in contact with regulators, investment bankers, and so on. Their decisions derive from a nexus of contacts with interested parties. To board members, the parameters of efficient compliance are determined by a set of professional opinions, few of which do not simply justify the decisions that management prefers. Of those opinions that are independent, however, their authors are most likely independent from the corporation and thus not likely to be grounded by contacts with corporate stakeholders. In sum, directors normally do not become aware of the non-legally enforceable norms embodied in the risk logics that guide executive action.

Even with a QLCC, board members would be confronting "law compliance in the abstract."\textsuperscript{272} Replacing corporate officers on boards with independent directors increases the abstraction. The QLCC not only presumes compliance, it also presumes command-and-control styles of state regulation. In fact, regulation is a negotiated process, and directors are rarely part of that process.

A QLCC could leave the normal determination of compliance levels to executives and serve only to strategize about these levels. Individual reports would occasion corporate self-examination. QLCCs could be another contact in executives' nexus of contacts and could be part of the

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{270} Murphy, \textit{supra} note 207, at 65 (quoting British Telecom's regulatory compliance officer).
\item \textsuperscript{271} Melvin A. Eisenberg, \textit{The Board of Directors and Internal Control}, 19 Cardozo L. Rev. 237, 240 (1997) (emphasis omitted).
\item \textsuperscript{272} Williams, \textit{supra} note 248, at 1304 (quoting The Bus. Roundtable, Statement of the Business Roundtable on the American Law Institute's Proposed "Principles of Corporate Governance and Structure: Restatement and Recommendations" 45 (1983)).
\end{itemize}
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negotiating process. So limited, QLCCs might not have the disadvantages of making decisions from scratch in the abstract.

QLCCs, however, require directors to act by a voting process. Discussion and decisions would be recorded in the committee’s minutes. QLCCs thus have the potential for making directors accountable for corporate legal compliance decisions. By making transparent decisions, the QLCC allows corporations to be held to account, understanding that “to be ‘accountable’ for one’s activities is to explicate the reasons for them and to supply the normative grounds whereby they may be justified.”

Creating a process for transparent decisions in response to particular reports of violations solves a basic problem of self-regulation. Christine Parker usefully argues that, unless regulators publicly report on corporate substantive compliance, regulators can too easily be corrupted. She marshals evidence showing that regulators’ “compliance program audits focus more on reviewing (and recommending improvements to) the systems elements of the compliance program, rather than its compliance performance.” This “delivers the message that the compliance program is essentially adequate and that problems are merely aberrations.” A QLCC solves this problem by having the corporation, rather than the regulators, publicly report on substantive compliance, at least in response to the violations reported to it.

But why should a board adopt this transparent process?

SOX’s and the SEC’s strategy of raising issues up the ladder presumes that directors are more interested in legal compliance than are executives. Normal agency-cost analysis challenges this presumption. The representative function of directors also does not support it. Directors’ fears of liability might explain it, but these fears also explain why directors do not want issues raised up the ladder.

As compared to directors, managers and executives have greater nondiversified investments in the firm. Executives are not only likely to have a greater portion of their wealth invested in the company, but their future prospects for generating wealth are also more closely tied to a specific company. Their investments, especially in the form of human capital, are relatively illiquid. They have greater incentives than directors to be risk averse in regards to corporate losses from discoverable noncompliance. Except in “last period” scenarios, directors are more likely to approve noncompliance than executives.

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275. Id. at 224.
276. Id. at 234.
As representatives of shareholders, in large public companies where shareholders have diversified portfolios, directors have further incentives to act with less risk aversion than executives in regards to compliance. The shareholder is concerned about market risks, but not company-specific risks. As the shareholder’s representatives, directors should approve risk-taking activities. For example, a board represents shareholders when it decides not to disclose material that has negative impact on stock price. Boards have done so and have refused to disclose even when advised by lawyers that they are legally obligated to disclose.278

If directors are more risk averse, it is because of their own interests, not those of shareholders. Imposing director liability is conducive to creating this risk averseness (and consequently greater legal compliance), but also to creating a conflict of interest between directors and shareholders.279

The SEC asserts that service on QLCCs will not increase director liability: “[T]he commission does not intend service on a QLCC to increase the liability of any member of a board of directors under state law and, indeed, expressly finds that it would be inconsistent with the public interest for a court to so conclude.”280 The conflict between the interests of shareholders and directors’ fears of liability is hidden, while it is exploited by the SEC in hopes of increasing compliance.

Nonetheless, lawyers reported that they did not recommend QLCCs because directors would be concerned about their liability. For example, “[d]irectors might be reluctant to join a QLCC before the . . . legal risks of the position become more apparent.”281 Lawyers have reasons to overstate legal risks and may be doing so here.282 But the hesitance to recommend QLCCs because of liability fears is not without substance: “Courts have


278. Paul Braverman, Catalog of Horrors, Law.com, Feb. 13, 2004, http://www.law.com/jsp/article.jsp?id=1071719723587 (discussing a suit against Spiegel Inc. for failing to include in its annual 10-K Form its auditor’s conclusion that there was “substantial doubt about the company’s ability to continue as a going concern for a reasonable period of time”).


281. Romanek & Winer, supra note 191, at 54.

created a muddled law governing the liability of corporate directors to holders of securities for the illegal acts of a corporation." 283

Theoretically, a director who knowingly approves actions that violate the law violates her duty of care. 284 Statutorily, directors have no immunity for damages arising from a "knowing violation of law." 285 Officially, corporations adopt codes of conduct requiring compliance with the law. Historically, directors who caused the corporation to violate the law were liable to the corporation for these ultra vires actions. 286

Realistically, directors have not faced liability to shareholders, even when they intentionally cause the corporation to violate the law. 287 The legal principle that directors may not knowingly approve illegal actions is limited, in practice, by requiring proof of "knowing" according to a high standard, or by requiring culpability in addition to knowledge. Liability may be negated by the existence of a lawyer's opinion that the action was not clearly illegal, or liability may be rendered immaterial by allowing indemnification. 288 Corporate codes of conduct are not understood to create liability. Except for those caught up in moral panics, directors can rely on history's having empowered corporations, not limited them, and protected directors, not allowed them to be sanctioned.

There is ambiguity about the board's obligation to obey the law. 289 This can stimulate compliance, as directors strive to reduce uncertainty, even when directors are not sanctioned for noncompliance. 290 But this uncertainty does not work to stimulate the adoption of QLCCs. First, reports to the QLCC can themselves hurt corporations, even if they are unfounded. It is not noncompliance that negatively affects stock price, but


287. See generally Beveridge, supra note 286, at 743-45 (describing how, in practice, the "net-loss" and pre-suit demand requirements prevent directors from incurring liability).

288. Id. at 746-54. Even in the high-watermark case for board responsibility, the board was authorized to engage in conduct when it had been "informed by experts that the company's practices" were "contestable." In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996).


290. "Regulated business firms' perceptions of legal risk play a far more important role in shaping firm behavior than the objective likelihood of legal sanctions." Neil A. Gunningham et al., Motivating Management: Corporate Compliance in Environmental Protection, 27 Law & Pol'y 289, 290 (2005) (citations omitted).
an announcement or allegations of noncompliance. If directors on notice, the QLCC can only increase the possibilities of director liability. As Steven Lauer notes, "If a board has received information through the [QLCC,] . . . [s]ome sort of duty to investigate probably [arises]. . . . For that reason, simply setting up a [QLCC] might create more liability than it satisfies."

If directors' fears of liability make them more risk-averse than managers regarding legal compliance, then it also explains why they, and the lawyers who advise them, will resist the establishment of QLCCs. For directors, their involvement in legal compliance has only downside risks. This, then, is merely another instance of standards of liability favoring corporations taking uninformed decisions.

Directors seek to evade the coalface.

III. SECRETARY: AN EFFECTIVE CONDUIT BETWEEN BOARD AND MANAGEMENT

All lawyers who work for a corporation are conflicted when advising the board about whether or not to adopt QLCCs. As Robert Marmer et al. have noted, "[A]n issuer’s CLO and its regular outside securities counsel may have their own interests in the compliance and reporting procedures that the issuer adopts and providing legal advice on these procedures may involve conflicts of interest." Yet interviewed lawyers failed to spot these conflicts.

The board is entitled to and needs unbiased advice on governance possibilities. At least one court has required the CLO to perform this educational role. It is doubtful, however, whether CLOs can be unbiased about QLCCs. More important, a CLO is unlikely to entertain the board's perspective on governance. QLCCs, for example, may be valuable not only for their effectiveness in responding to lawyer reports, but also as "`legal cover' [for directors] to engage in a number of practices designed to

291. See Williams, supra note 134, at 1278-82 (citations omitted).
293. See W. Kip Viscusi, Corporate Risk Analysis: A Reckless Act?, 52 Stan. L. Rev. 547, 586 (2000) (discussing a study that revealed that citizen-jurors imposed higher damages on companies that conducted cost-benefit analyses, and observing that "many of the most well-known cases involving punitive damages are also those in which corporations undertook a risk analysis, or in some cases, a sound benefit-cost analysis").
294. If inside counsel oppose QLCCs, their self-interest in not being reviewed creates a potential bias. If inside counsel favor QLCCs, their self-interest in avoiding accountability creates a potential bias. If outside counsel who have been retained by the issuer oppose QLCCs, their interest in currying favor with those who purchase their services—inside lawyers and management—creates a potential bias. If they favor QLCCs, outside counsel may be biased by desires either to have direct access to the highest powers or to avoid troubling professional responsibilities.
improve board culture and empower the independent directors vis-à-vis management."²⁹⁷ CLOs, as part of management, are not in a position to render such advice.

Recognizing these conflicts of interest, Professors Geoffrey C. Hazard and Edward B. Rock²⁹⁸ and Professor James Cox,²⁹⁹ echoing an idea once advanced by Justice Arthur Goldberg,³⁰⁰ have called for the board to hire an outside firm to be its counsel. Hazard and Rock suggest that the responsibilities imposed on the audit, nominating, and compensation committees will lead to the emergence of "the Independent Directors' Counsel" ("IDC").³⁰¹ The IDC is the carrier of the "independent and influential counselor" image of the legal role.³⁰² The IDC could provide unconflicted corporate governance advice to the board.

Hazard and Rock describe not the emergence, but the reemergence of the IDC. When inside counsel were under the tutelage of outside counsel, many outside counsel functioned as IDCs. A member of an outside firm was often a member of the board. He or another lawyer at his firm served as the board's secretary. Later, the secretarial role was split off and the general counsel became the board's secretary. But the general counsel was still a functionary of the outside law firm. He was someone who did not make partner and had no resources to stand up to the outside firm. The inside counsel movement changed that, and the board's secretary became the "enlightened" CLO, whose allocation of work to different outside firms gave him power over outside counsel.³⁰³ As a result, when the "independent and influential counselor" appeared, the role was played by the CLO.

Hazard and Rock's strongest argument for the reemergence of IDCs is that, when independent directors meet outside the presence of any senior

²⁹⁸. Hazard & Rock, supra note 152.
³⁰⁰. See id. at 1090 n.42 (citing Arthur J. Goldberg, Debate on Outside Directors, N.Y. Times, Oct. 29, 1972, § 3, at 1).
³⁰¹. See Hazard & Rock, supra note 152, at 1396; see also Davis, supra note 128, at 26 (observing that audit committees hire outside firms who are not their regular counsel). Zion Oil and Gas, Inc., established a "QLCC Counsel," but authorized the QLCC to select the CLO as the committee's counsel. Zion Oil & Gas, Inc., Audit Committee Charter, QLCC Addendum, Part 205 Report Procedures (2), available at http://www.zionoil.com/company/auditcharter.pdf (last visited Nov. 10, 2005) (Notice and Meeting).
³⁰². For a discussion of the "independent and influential counselor" role and its declining significance for outside counsel in the last decades of the twentieth century, see Robert A. Kagan & Robert Eli Rosen, On the Social Significance of Large Law Firm Practice, 37 Stan. L. Rev. 399 (1985). Like either the outside or inside counsel in the "independent and influential counselor" image, the Independent Directors' Counsel ("IDC") will emphasize the advantages that accrue from the fact that they "will be more familiar with the company and will have already established a relationship with the independent directors." Hazard & Rock, supra note 152, at 1404.
³⁰³. See Rosen, supra note 118, at 479.
officer, they will not be able to include the CLO in their meeting. The need for corporate minutes of executive sessions, to establish due care, creates a problem when the general counsel is also the secretary. One answer is for "a committee member to 'debrief' the corporate secretary after an executive session on the topics discussed, but to stay away from specifics." This is hardly ideal. Hazard and Rock conclude that "either the meeting has to be held without a lawyer being present (clearly a bad idea), or the independent directors will need an IDC."  

This conclusion follows because Hazard and Rock presume that the board's secretary is the general counsel. This is not necessarily the case. The secretary can be an agent of the board, independent of other corporate functions.

Hazard and Rock's presumption reflects current realities for the largest corporations. A survey of CLOs found that more than one-half of them were also the corporate secretary. The same survey found that, in other corporations, the secretary reported to the CLO. In total, in eighty-one percent of companies, the corporate secretary either was or reported to the general counsel. A survey of corporate secretaries found that nearly seven out of ten have law degrees. This survey did not find the same proportion of secretaries reporting to the CLO, but less than half reported to the board and only thirty-eight percent had their compensation set by the board or the compensation committee. Both surveys confirm the likelihood that the board's secretary is not independent and often is beholden to the CLO.

An effective board is one that has properly managed information flowing to it from all parts of the corporation. What boards need is someone to fill the role of "[g]etting the 'right' information to boards and helping them

306. Hazard & Rock, supra note 152, at 1403.
307. See Ass'n of Corp. Counsel, supra note 125, at 10 (quoting Altman Weil Inc. & Ass'n of Corp. Counsel, supra note 125).
308. Id. at 9.
309. Soc'y of Corp. Sec'y's & Governance Prof'l's & Korn/Ferry Int'l, Compensation Survey Report 2004, at 3 (2004). Not all of those secretaries also represent the corporation as a lawyer. Compare Tables A and B of the survey. Id. But see id. at 4 (Table E) (observing that seventy-two percent of corporate secretaries' departments were located in legal departments).
310. Id. at 5 tbl.G.
311. The Council of Institutional Investors guidelines now require the board to "name a lead independent director who would have approval over information flow to the board, meeting agenda, and meeting schedules to ensure balance between the powers of the CEO and the independent directors." Alison Carpenter, Investor Group at Crossroads, Mulls Playing More Active Role, Corp. Accountability Rep. (BNA), Oct. 29, 2004, at 1154, 1155.
understand corporate strategy and issues relating to risk."\textsuperscript{312} The ABA's Cheek Report determined that there was a need for boards to establish "[p]rocesses for setting agendas and distributing information."\textsuperscript{313} It also recommended the "maintenance of a training and education program for all directors . . . in regard to . . . the financial condition, the principal operating risks and the performance factors" of the corporation, among other things.\textsuperscript{314} Who can perform these functions?

What the board needs is not so much a wise counselor, as an effective conduit between it and management. General counsel like to see themselves in this role, serving as a "bridge between the executive management of the company and the board."\textsuperscript{315} But this can lead to conflicts, as with QLCCs. What the board needs is its own conduit.

Some companies have created a conduit by creating a role for a "governance officer." A chief governance officer is "often a legally trained executive who oversees a company's corporate governance issues and acts as a liaison with the board and with investors."\textsuperscript{316} In other corporations, the conduit may lead an "office of strategy management" whose task is to communicate corporate strategies, reinforce strategy priorities among executives, serve as the "guardian of the [strategy] scorecard . . . [who] standardizes the terminology and measurement definitions across the organization . . . and ensure[] the integrity of the . . . data."\textsuperscript{317}

Whatever the role is named and however its parameters are defined, the conduit between the board and management must be independent from the executives and management. The conduit must afford the board "competitive sources of information" to respond to the gaps in knowledge that may be presented to the board.\textsuperscript{318}

Instead of Hazard and Rock's "IDC," I propose that large corporations segregate the office of the CLO and that of the secretary to the board of directors. For smaller corporations, the costs of this segregation may be too high. These costs, however, are reduced as the parameters of the secretary's job are expanded—for example, by making the secretary also the corporate governance, internal audit, or strategy management officer.

Today, the corporate secretarial function is ministerial. The secretary deals with mundane, detailed, paper-shuffling, time-consuming tasks. The secretary sends out meeting notices, maintains calendars, takes charge of

\textsuperscript{312} General Counsel Is Gatekeeper: Must Get 'Right' Information to Board, supra note 305, at 157 (quoting Holly J. Gregory, Partner, Corporate Governance Group, Weil, Gotshal & Manges LLP).

\textsuperscript{313} Cheek Report, supra note 14, at 71.

\textsuperscript{314} Id. at 72.

\textsuperscript{315} Hackett, supra note 119, at 25.

\textsuperscript{316} Tamara Loomis, Companies Are Hiring Chief Governance Officers, Nat'l L.J., May 5, 2003, at A15.


\textsuperscript{318} Eisenberg, supra note 271, at 246 (arguing that the internal audit function be placed under the board's control).
and maintains books and records, issues certificates of authority, keeps the
insurance and shareholder lists up-to-date, and so on. It is not difficult to
understand why it has been ignored in discussions of reforming corporate
governance.

Many of these tasks may be expanded to suit the needs of effective
boards. The secretary, for example, is in charge of collating and
distributing materials for meetings. Ensuring that the appropriate materials
are before the board, preparing them in a manner accessible to the different
members of the board, sometimes developing the materials themselves, are
all necessary for an effective meeting. Today, this is usually not the
secretary’s task, nor often is it anyone else’s. Expanding the secretarial role
is one option for ensuring that the right information gets to the board.

Because the secretary typically causes reports to be filed with the SEC,
including insider trading reports, the secretary is in contact with multiple
sources of information. A good secretary is a superb informational
intermediary. An effective board needs a secretary who can proactively
develop contacts and determine what information is needed by the board.

The secretary typically authors the corporate minutes. Writing corporate
minutes has always been an art form. It is a form that must be responsive to
the changing work and style of the board. A board is entitled to expect that
the minutes will be drafted with their interests, among others, in mind. A
legally trained individual whom the board hired would best meet such
needs. Members of the legal department, however, can be conflicted as the
board becomes more actively engaged in monitoring compliance. A legally
trained secretary who reports to and whose compensation is determined by
the board would better serve board interests.

Hazard and Rock describe a function that needs to be performed for
boards to be effective. Their IDC solution, however, has a basic problem
for a board uncertain about liability: The retention of an IDC may show
that the board was aware of the existence of a conflict.319 Having the IDC
role performed by an ongoing functionary of the board, such as a secretary,
mitigates this problem. The board’s secretary may be an outside counsel, as
has been the case in the past. An employee of the board who is located in
corporate headquarters, however, has the advantage of the informal contacts
that location makes possible. Good secretaries know the value to their
superiors of water fountains and coffee pots.

319. In fact, Hazard and Rock do not suggest that the directors’ lawyers will be
independent from them. For example, “in at least a significant proportion of these situations,
the IDC may not be considered sufficiently independent.” Hazard & Rock, supra note 152,
at 1412; see also Frank Aquila & Barbara Lynn Burns, Too Many Cooks? Separate Advisors
for Independent Directors in M&A Transactions, 8 M&A Law. 16 (2005) (asserting that the
retention of separate counsel as IDC is evidence of the board’s knowledge that it had a
conflict).
CONCLUSION

This is a story of resistance. Legal professionals, both inside and outside the corporation, have decided that QLCCs threaten dominant hierarchical relations. Perhaps it is simply that "any alternative to the existing structure . . . appear[s] as a threat" and lawyers can be "expect[ed] . . . to play a conservative role." But resistance to QLCCs constructs a boundary between the corporation and its legal environment. There is a buffering, a sealing off, of the Board of Directors from both the managerial core and from responsibility for legal compliance. Resistance to QLCCs is resistance to transparency about corporate legal and regulatory noncompliance.

Much of this resistance has not been straightforward. Lawyers have manufactured uncertainty about QLCCs. The ACC claims to be "generally supportive of the QLCC conceptually" but is "withholding final judgment until we know more about how it will actually operate." CLOs, however, can greatly influence how the QLCC operates at their corporation. Outside counsel also advise clients about uncertainties regarding QLCCs. For example, one detailed memo concludes that it is "not entirely clear how the QLCC will actually function," and that there is a "lack of guidance," "[no] definitive answers," "no clear standard," and a "lack of clarity." Yet, to this memo, the firm attaches model QLCC policies. Another offers tepid support for QLCCs, while advising clients that others have not adopted QLCCs and noting that whether one should adopt a QLCC depends on unstated characteristics of the corporation's "own culture, structure and needs."

Organizations and professional actors can implement procedures even in the face of vague regulations, as the model policies presented indicate. In fact, the vagueness of a legal regime can become an incentive for the adoption of innovations. Resistance to QLCCs is another story of legal professionals maintaining boundaries between democratic politics and the governance of corporations. Lawyers, through their practices and their ideologies of practice, construct and maintain these boundaries.

322. See supra notes 164-74 and accompanying text.
323. McLaughlin et al., supra note 59, at 16.
The QLCC is not the first proposal for involving the board in legal compliance. In response to proposals considered by the American Law Institute in developing its Principles of Corporate Governance, the Business Roundtable argued that "[a] free-floating concern with law compliance in the abstract would . . . open directors to unfair liability for acts committed by others of which they had neither knowledge nor notice."[^26] This argument carried the day and the proposals were rejected. The QLCC, however, responds to the Business Roundtable’s argument, because a QLCC is a dormant committee until an attorney provides it with material evidence. Furthermore, the QLCC requires limited involvement of the board in compliance. The board becomes involved only when an attorney cannot resolve his or her ethical concerns, despite economic and organizational incentives to do so. Nevertheless, lawyers resist QLCC formation. Rather than being agents for greater involvement of the board in legal compliance, lawyers have stymied corporate governance reform. Given that boards "are likely to rely heavily on . . . their attorneys’ advice,"[^27] pressures other than coercion do not appear capable of engaging the board in legal compliance.

Legal compliance, it should be noted, is a minimal legitimacy demand. Given corporate powers, legitimacy may demand that corporations consider the public interest in its actions.[^28] Given the range of interests that corporations effect, and given the diversity of corporations’ stakeholders, legitimacy may demand that corporations be democratically accountable by incorporating stakeholders in corporate decision making.[^29]

The focus of this Article on structuring decisions about legal compliance, although important and appropriate for an analysis of QLCCs, needs to be contextualized. QLCCs emerged in response to the fin de siècle corporate scandals. These public, corporate failures are constructed as breaches of law.[^30] Directors are presumed to approve such breaches unknowingly; had the board known of the illegalities, they would have prevented the scandals. Of course, this story—even if obvious—is constructed, not necessary. Its presumption that the scandals resulted not from normal business behavior, but from legal noncompliance, is particularly problematic. When I was growing up, the only businesses that consistently made twenty-six percent profits were loan sharks, and they had to break legs to do so. Now, even my local newspaper is required to make at least that rate of return.

[^26]: Williams, supra note 248, at 1304 (quoting The Bus. Roundtable, supra note 272, at 45).
[^27]: Fisch & Gentile, supra note 14, at 546.
[^29]: For a thoughtful analysis, see Christine Parker, The Open Corporation: Effective Self-Regulation and Democracy (2002).
[^30]: But see Rosen, supra note 255, at 1171 (characterizing Enron’s demise as resulting, not from legal violations, but from bad business decisions).
The focus of QLCCs on hierarchical control of corporate noncompliance also needs to be contextualized. In the corporate world, hierarchy is giving way to markets, both those internal to the corporation and those outside it. Inside the corporation, command-and-control organization of power is giving way to project team organization. The escape of project teams from hierarchical oversight was one cause of the Enron scandal. Corporations also externalize noncompliance by outsourcing; in other words, by increasingly relying on markets outside of the corporation. Instead of utilizing hierarchy, corporations are increasingly using contracts and finding means, not only to prevent holdups, but also to gain leverage over their contracting partners. Increasing board control over corporate actors, such as through the adoption of QLCCs, increases hierarchy costs, thereby rendering more palatable the costs of negotiating and writing contracts and the costs of monitoring and enforcing contractual performance. The externalization of legal responsibility is as much a story of our times as is the diffusion of QLCCs.

331. See supra notes 104-06 and accompanying text.
332. See generally Rosen, supra note 255, at 1166.
### APPENDIX: COMPANIES THAT REPORTED TO EDGAR THAT THEY ESTABLISHED QLCCS BETWEEN OCTOBER 1, 2002, AND SEPTEMBER 30, 2005

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<td>AMERICAN PHYSICIANS CAPITAL</td>
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<tr>
<td>AMERICAN POWER CONVERSION CORP.</td>
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<tr>
<td>AMERICAN SELECT PORTFOLIO FUNDS</td>
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<tr>
<td>AMERICAN STRATEGIC INCOME PORTFOLIO</td>
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<tr>
<td>AMERICAN STRATEGIC INCOME PORTFOLIO I</td>
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<td>AMERICAN STRATEGIC INCOME PORTFOLIO II</td>
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<td>AMERICAN STRATEGIC INCOME PORTFOLIO III</td>
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<tr>
<td>AMERINDO FUNDS</td>
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<td>AMERIVEST PROPERTIES</td>
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<td>AMPCO PITTSBURGH</td>
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<tr>
<td>AMSTAR INVESTMENT TRUST</td>
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<tr>
<td>APA ENTERPRISES INC.</td>
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<tr>
<td>ARCH CAPITAL GROUP</td>
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<tr>
<td>ARKANSAS BEST</td>
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<tr>
<td>A T FUNDS INVESTMENT TRUST</td>
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<tr>
<td>ATLANTA SOSNOFF INVESTMENTS TRUST</td>
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<tr>
<td>ATLAS ASSETS INC.</td>
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<td>BANCROFT CONVERTIBLE FUND</td>
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<tr>
<td>BANK ONE CORP.</td>
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<td>BB&amp;T FUNDS</td>
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<td>BEAR STEARNS</td>
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<td>BECTON DICKINSON &amp; CO.</td>
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<tr>
<td>BEI TECHNOLOGIES</td>
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<td>BERKSHIRE BANCORP</td>
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<td>BLUECHIP VALUE FUND</td>
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<td>BOSTON RESTAURANT ASSOCIATES</td>
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<td>BOULDER GROWTH AND INCOME FUND</td>
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<td>BOULDER TOTAL RETURN FUND</td>
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<td>BRANDPARTNERS GROUP INC.</td>
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<td>BRANDES INVESTMENT TRUST</td>
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<tr>
<td>BRIDGES INVESTMENT FUND</td>
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<td>BROOKTROUT INC.</td>
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<td>BRUNSWICK CORP.</td>
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<tr>
<td>BRYCE CAPITAL FUNDS</td>
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<td>CALDWELL &amp; ORKIN FUNDS</td>
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<td>CALLIDUS SOFTWARE</td>
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<td>CAPITAL MANAGEMENT INVESTMENT TRUST</td>
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<td>CAPSTONE TURBINE</td>
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<td>CELL GENESIS</td>
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<td>CHARLES &amp; COLVARD LTD.</td>
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<td>CHARTWELL DIVIDEND AND INCOME FUND</td>
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<tr>
<td>CHROMECRAFT REVININGTON INC.</td>
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<tr>
<td>CIBER INC.</td>
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<td>CIGNA HIGH INCOME SHARES</td>
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<td>CITIZENS BANKING CORP.</td>
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<td>CITRIX SYSTEMS</td>
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<td>CLEAN DIESEL TECHNOLOGIES</td>
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<td>CLECO CORP.</td>
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<td>CLECO UTILITY GROUP, INC.</td>
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</table>

333. See supra note 36.
RESISTANCES TO REFORMING

CLOROX INC.
COLE NATIONAL CORP.
COLLECTORS UNIVERSE INC.
COLONIAL PROPERTIES TRUST
COMERICA INC.
COMMERCE BANCORP
COMMERCE ENERGY GROUP
COMMERCE ONE INC.
COMPUWARE
CORNERSTONE STRATEGIC VALUE FUND
COSI INC.
COST PLUS
COUNTRY MUTUAL FUNDS TRUST
COWLITZ BANCORP
CRAFTMADE INTERNATIONAL CRANE CO.
CREDIT ACCEPTANCE CORP.
CSFB ALTERNATIVE CAP EVNT DRIVN FUND
CSFB ALTERNATIVE CAP LONG SH EQ FUND
CSFB ALTERNATIVE CAP MULTI STRGY FUND
CSFB ALTERNATIVE CAP RELTV VAL FUND
CSFB ALTERNATIVE CAP TACTL TRG FUND
CSK AUTO CORP.
CSP INC.
CULLEN FUNDS TRUST
CYBERKINETICS
NEUROTECHNOLOGY SYSTEMS
DANIELSON HOLDING CO.
DDI CORP
DELPHI CORP.
DEVELOPED TECHNOLOGY RESOURCE
DIGIMARC CORP.
DIGIRAD CORP.
DIVERSIFIED CORPORATE RESOURCES
DOLBY LABORATORIES
DOTHILL SYSTEMS CORP.
DSL NET
ECTEL LTD.
ELLSWORTH CONVERTIBLE GROWTH & INCOME FUND
EL PASO ELECTRIC CO.
ENERGY INCOME & GROWTH FUND
ENTERTAINMENT PROPERTIES TRUST
ENTROPIN, INC.
EVERGREEN EQUITY TRUST
EVERGREEN FIXED INCOME TRUST
EVERGREEN INCOME ADVANTAGE FUND
EVERGREEN INTERNATIONAL BALANCED INCOME FUND
EVERGREEN INTERNATIONAL TRUST
EVERGREEN MANAGED INCOME FUND
EVERGREEN MONEY MARKET TRUST
EVERGREEN MUNICIPAL TRUST
EVERGREEN RESOURCES, INC.
EVERGREEN SELECT EQUITY
EVERGREEN SELECT FIXED INCOME TRUST
EVERGREEN SELECT MONEY MARKET TRUST
EVERGREEN UTILITIES AND HIGH INCOME FUND
EVERGREEN VARIABLE ANNUITY TRUST
EVERLAST WORLDWIDE
EXELIXIS INC.
EXTENDED STAY AMERICA FEI CO.
FIELDSTONE INVESTMENT CORP.
FIRST AMERICAN INSURANCE PORTFOLIOS
FIRST AMERICAN MINN MUN INCOMES FUND II
FIRST DATA CORP.
FIRST FINANCIAL FUND, INC.
FIRST NATIONAL LINCOLN CORP.
FIRST REGIONAL BANCORP
FIRST STATE FINANCIAL CORP.
FIRST TRUST ABERDEEN GLBL OPPTY INCOME FD
FIRST TRUST FIDUCIARY AST MGMT COVRD CALL FD
FIRST TRUST FOUR CRNRS SR FLTG RT INC FD
FIRST TRUST FOUR CRNRS SR FLTG RT INC FD II
FIRST TRUST VALUE LINE DIVIDEND FUND
FIRST TRUST VALUE LINE 100 FUND
FIRST TRUST VAL LINE & IBBOTSON EQ ALLOCTN FD
FLORIDA CHOICE BANKSHARES INC.
FOOTHILL INDEPENDENT BANCORP
FOUNDRY NETWORKS
FORT PITT CAPITAL FUNDS
FORUM FUNDS
FRANKLIN TEMPLETON LTD DURATION INC. TR
FREQUENCY ELECTRONICS
FUEL-TECH N.V.
GAINSCO INC.
GAP INC.
GARDNER LEWIS INVESTMENT TRUST
GELSTAT CORP.
GENERAL MOTORS CORP.
GETTY REALTY CORP. MARYLAND
GIORDANO INVESTMENT TRUST
GLOBECOMM SYSTEMS
GLYCOGENESYS
GRAFTECH INTERNATIONAL
GRANITE CONSTRUCTION INC.
GREAT ATLANTIC & PACIFIC TEA CO.
GREENBRIER COS INC.
GREEN CENTURY FUNDS
HAIN CELESTIAL GROUP
HALIFAX CORP.
HANOVER FOODS CORP.
HARDING LOEVNER FUNDS
HAWK
HEICO CORP.
HERITAGE CAPITAL APPRECIATION TRUST
HERITAGE CASH TRUST
HERITAGE GROWTH & INCOME TRUST
HERITAGE INCOME TRUST
HERITAGE SERIES TRUST
HEXCEL CORP.
HIGHLAND CORPORATE OPPORTUNITIES FUND
HIGHLAND FLOATING RATE ADVANTAGE FUND
HIGHLAND FLOATING RATE LLC
HIGHLAND INSTITUTIONAL FLOATING RATE INCOME FUND
HIGH YIELD PLUS FUND INC.
HILLMAN CAPITAL MANAGEMENT INVESTMENT TRUST
HILTON HOTELS
HINES HORTICULTURAL

H&Q HEALTHCARE INVESTORS
H&Q LIFE SCIENCES INVESTORS
HUNTINGTON VA FUNDS
HUNTINGTON FUNDS MA
ICM SERIES TRUST
IMCOR PHARMACEUTICAL
INDYMAC BANCORP
ING GET FUND
ING INVESTORS TRUST
ING MAYFLOWER TRUST
ING MUTUAL FUNDS
ING PARTNERS
ING SENIOR INCOME FUND
ING SERIES FUND
ING STRATEGIC ALLOCATION PORTFOLIOS
ING VARIABLE FUNDS
ING VARIABLE INSURANCE TRUST
ING VARIABLE PORTFOLIOS
ING VARIABLE PORTFOLIOS BALANCED PORTFOLIO
ING VARIABLE PORTFOLIOS BOND PORTFOLIO
ING VARIABLE PORTFOLIOS MONEY MARKET PORTFOLIO
ING VARIABLE PORTFOLIOS NATURAL RESOURCES TRUST
ING VARIABLE PRODUCTS TRUST INTELLIGROUP INC.
INTERMUNE
INTRICON CORP.
J&J SNACK FOODS CORP.
JOHN HANCOCK BANK & THRIFT OPPORTUNITY FUND
JOHN HANCOCK BOND TRUST
JOHN HANCOCK CA TAX FREE INCOME FUND
JOHN HANCOCK CAPITAL SERIES
JOHN HANCOCK CURRENT INTEREST
JOHN HANCOCK EQUITY TRUST
JOHN HANCOCK FINANCIAL TRENDS FUND
JOHN HANCOCK INCOME SECURITIES TRUST
JOHN HANCOCK INSTITUTIONAL SERIES TRUST
JOHN HANCOCK INVESTMENT TRUST
JOHN HANCOCK INVESTMENT TRUST II
JOHN HANCOCK INVESTORS TRUST
NOTTINGHAM INVESTMENT TRUST
NT ALPHA STRATEGIES FUND
NUVELO INC.
NVR INC.
OFI TREMONT CORE STRATEGIES HEDGE FUND
OFI TREMONT MARKET NEUTRAL HEDGE FUND
OMNICOM GROUP INC.
ONE GROUP
ONE GROUP INVESTMENT TRUST
ONE GROUP MUTUAL FUNDS
OPLINK COMMUNICATIONS
OPPENHEIMER CONVERTIBLE SECURITIES
OPPENHEIMER INTL LARGE CAP CORE TRUST
OPPENHEIMER INTERNATIONAL VALUE TRUST
OPPENHEIMER LTD. TERM CALIFORNIA MUN FUND
OPPENHEIMER MIDCAP FUND
OPPENHEIMER PORTFOLIO SERIES
OPPENHEIMER QUEST CAPITAL VALUE FUND
OPPENHEIMER QUEST FOR VALUE FUND
OPPENHEIMER QUEST INTERNATIONAL FUND
OPPENHEIMER QUEST VALUE FUND
OPPENHEIMER REAL ESTATE FUND
OPPENHEIMER SELECT VALUE FUND
OPPENHEIMER TOTAL RETURN BOND FUND
OPPENHEIMER TREMONT MKT NEUTRAL FD
OPPENHEIMER TREMONT OPPORTUNITY FD L L C
ORCKIT COMMUNICATIONS
OXIS INTERNATIONAL
PACIFIC CAPITAL FUNDS
PACIFIC MERCANTILE BANCORP
PAC WEST TELECOMM
PENFORD CORP.
PENNSYLVANIA COMMERCE BANCORP
PENWEST PHARMACEUTICALS CO
PEPSIAMERICAS
PERCEPTRON INC.
PETSINC
SPORTSLINE.COM INC.
SRS LABS
SSGA FUNDS
SSP SOLUTIONS INC.
STATE AUTO FINANCIAL
STEPAN CO.
STEVEN MADDEN LTD.
STRATTON FUNDS INC.
STRATTON GROWTH FUND INC.
STRATTON MONTHLY DIVIDEND REIT
STRESSGEN BIOTECHNOLOGIES
SUNCOAST BANCORP
SUREWEST COMMUNICATIONS
SYNOPSYS INC.
TARPON COAST BANCORP
TELEDYNE TECHNOLOGIES INC.
TELIK INC.
TEMPLETON DRAGON FUND
TEMPLETON EMERGING MARKETS FUND
TEMPLETON GLOBAL BALANCED INCOME FUND
TEMPLETON GLOBAL INCOME FUND
TEMPLETON RUSSIA & EAST EUROPEAN FUND
TFS CAPITAL INVESTMENT TRUST
TIKRO TECHNOLOGIES LTD.
TILSON INVESTMENT TRUST
TIME WARNER INC.
TIMKEN CO.
TOCQUEVILLE ALEXIS TRUST
TOCQUEVILLE TRUST
TOLL BROTHERS INC.
TOLLGRADE COMMUNICATIONS
TRANSALTA CORP.
TRANSWITCH CORP.
TRANS WORLD ENTERTAINMENT
TURNAROUND INVESTMENT TRUST
ULTRA PETROLEUM
UNITED COMMUNITY BANKSHARES OF FL
UNITED THERAPEUTICS
VENTURE FINANCIAL GROUP
V F CORP.
VICTORY INSTITUTIONAL FUNDS
VICTORY PORTFOLIOS
VICTORY VARIABLE INSURANCE FUNDS
VITROTECH CORP. N.V.
WEBSITE PROS INC.
WESTAR ENERGY INC.
WESTCORP
WFS FINANCIAL
WGNB CORP.
WILLIAMSBURG INVESTMENT TRUST
WILLIAMS INDUSTRIES
WILLAMS SONOMA
WILSHIRE MUTUAL FUNDS
WILSHIRE TARGET FUNDS
WINTERGREEN FUND
XATA CORP.
XCYTE THERAPIES
XENOGEN CORP. DEF
YOCREAM INTERNATIONAL
ZION OIL & GAS