THE ROLE OF BUSINESS COUNSEL AS COMPLIANCE GATEKEEPERS: TOWARD UNDERSTANDING AND COMBATTING RECKLESS DISREGARD FOR LEGAL AND ETHICAL COMPLIANCE IN BUSINESS ENTITIES

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Lawyers inform, guide, recommend, and advise. Clients decide and act. Most times, at least in my experience as outside corporate counsel, the principals of a business client are grateful for legal counsel's expertise and skills as a component of their planning and decision-making. As a result, the client and its agents act in accordance with legal counsel's suggestions on how the business should move forward legally—and ethically.

Sometimes, however, business entity clients and their principals do not seek, accept, or heed the advice of their lawyers. In fact, sometimes, they expressly disregard a lawyer's instructions on how to proceed. In certain cases, the client expressly rejects the lawyer's advice. However, some business constituents who take action contrary to the advice of legal counsel may fall out of compliance incrementally over time or signal compliance and yet (paradoxically) act in a noncompliant manner. These seemingly ineffectual varieties of the lawyer/client relationship are frustrating to the lawyer.

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In most of the cases I have seen, business managers have not ignored or disobeyed legal advice in order to violate law, non-legal duties, or even norms. Rather, it seems that legal and ethical compliance is not, for these folks, a priority. It is not part of their personal or professional fabric—who they are or what they do. In some cases, one might observe that the firm's operations or culture fail to value—or even devalue—obedience with legal or ethical principles.

This short article aims to explain why representatives of business entities who consider themselves law-abiding and ethical may nevertheless act in contravention of the business's legal counsel and offers preliminary means of addressing the proffered reasons for these compliance failures. The article does not address willful noncompliance or even willful blindness.[1] Rather, it makes observations about behavior that falls squarely into what the law typically recognizes as recklessness.[2] An apocryphal lawyer-client story provides foundational context.

I. AN INTRODUCTORY TALE OF INSIDER TRADING NONCOMPLIANCE

A private law firm, Legal & Ethical, PLLC ("L&E"), has been outside general counsel to a Delaware corporation, DEL Corporation ("DEL Corp."), for a number of years. DEL Corp.'s common stock trades on the NASDAQ Global Market. In light of provisions in, among other laws and regulations, the Foreign Corrupt Practices Act,[3] the Federal Sentencing Guidelines,[4] the Sarbanes-Oxley Act of 2002,[5] the

1. *See, e.g.*, Global-Tech Appliances, Inc. v. SEB S.A., 563 U.S. 754, 768–771 (2011); Joan MacLeod Heminway, *Willful Blindness, Plausible Deniability and Tippee Liability: SACS, Steven Cohen, and the Court's Opinion in Dirks*, 15 TRANSACTIONS 47, 54 (2013) ("Willful blindness is addressed under the criminal law doctrine of conscious avoidance, which may support a conviction on the basis of willful misconduct."); J. Kelly Strader, *(Re)Conceptualizing Insider Trading: United States v. Newman and the Intent to Defraud*, 80 BROOK. L. REV. 1419, 1447 (2015) ("The MPC and common law both provide that, when proof of knowledge is an element of a crime, proof that the defendant was willfully blind will suffice.").

2. *See Global-Tech*, 563 U.S. at 770 ("[A] reckless defendant is one who . . . knows of a substantial and unjustified risk of such wrongdoing").

3. *See* Foreign Corrupt Practices Act, Pub. L. No. 95–213, 91 Stat. 1494 (1977) (codified as amended at 15 U.S.C. §§ 78m(b), (d)(1), (g)–(h), 78dd-1 to -3, 78ff (2012)), *amended by* Foreign Corrupt Practices Act Amendments of 1988 (part of Omnibus Trade and Competitiveness Act of 1988), Pub. L. No. 100-418, 102 Stat. 1107, 1415 (codified at 15 U.S.C. §§ 78dd-1 to -3, 78ff), *and* International Anti-Bribery and Fair Competition Act of 1998, Pub. L. No. 105-366, 112 Stat. 3302 (codified at 15 U.S.C. §§ 78dd-1 to -3, 78ff).

4. *See, e.g.*, 18 U.S.C. §§ 8B2.1, 8B2.4(a), 8C4.11 (2012).

5. *See* Sarbanes-Oxley Act Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of 15 U.S.C. and 18 U.S.C.).

Dodd-Frank Wall Street Reform and Consumer Protection Act,[6] and the evolution of the fiduciary duty of loyalty under Delaware corporate law,[7] L&E recommends that DEL Corp. adopt a code of ethics and a series of compliance policies and procedures, constituting an overarching legal and ethical compliance program tailored to the firm and its business.[8] L&E advises DEL Corp. that this customized compliance program will put the firm in the best position to argue for dismissal of or favorable treatment in legal or regulatory actions against the firm alleging noncompliance.[9] DEL Corp. retains L&E to construct this compliance program.

The program includes a securities trading policy designed to, among other things, curtail conduct in connection with securities transactions that may violate rules prohibiting insider trading[10] and other securities fraud cognizable as deceptive conduct under Section 10(b) ("Section 10(b)") of the Securities Exchange Act of 1934, as amended ("1934 Act"),[11] and Rule 10b-5 ("Rule 10b-5") adopted by the U.S. Securities and Exchange Commission ("SEC") under Section 10(b).[12] L&E drafts

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6. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), *available at* http://www.dodd-frank-act.us.

7. *See, e.g.*, Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362 (Del. 2006); *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996); Graham v. Allis-Chalmers Mfg. Co., 41 Del. Ch. 78 (1963).

8. This advice is now commonplace. As one pair of commentators have written: "[I]t is organizational suicide not to have a corporate compliance plan." Pamela H. Bucy & Anthony A. Joseph, *Conducting Business in the Twenty-First Century: How to Avoid Organizational Suicide (Part 1)*, 70 ALA. L. REV. 184, 185 (2009) (footnote omitted). This was not true two decades ago. It is today for every business, from large, publicly-owned companies, to small, closely-held family businesses. Among other things, this means that any lawyer who advises a business client without ensuring that the client has an effective, updated, corporate compliance plan risks committing legal malpractice.

9. This value of compliance programs is widely cited. *See* Bucy & Joseph, *supra* note 8, at 188 ("[E]ffective corporate compliance plans are now a necessity for every business."); Donald C. Langevoort, *Monitoring: The Behavioral Economics of Corporate Compliance with Law*, 2002 COLUM. BUS. L. REV. 71, 72 ("A firm wants its employees to be sensitive to legal requirements in order to minimize the threat of legal sanctions and reputational harm that it faces when a violation occurs.").

10. For information about insider trading compliance plans, see John P. Anderson, *Anticipating a Sea Change for Insider Trading Law: From Trading Plan Crisis to Rational Reform*, 2015 UTAH L. REV. 339 (2015); John P. Anderson, *Solving the Paradox of Insider Trading Compliance*, 88 TEMP. L. REV. 273 (2016) [hereinafter "*Paradox*"]; Richard S. Gruner, *Lean Law Compliance: Confronting and Overcoming Legal Uncertainty in Business Enterprises and Other Complex Organizations*, 11 N.Y.U. J.L. & BUS. 247, 261–70 (2014); Marc I. Steinberg & John Fletcher, *Compliance Programs for Insider Trading*, 47 SMU L. REV. 1783 (1994).

11. 15 U.S.C. § 78j(b) (2012).

12. 17 C.F.R. § 240.10b-5 (2016).

the securities trading policy and presents it to DEL Corp. for approval and adoption.

The board reviews the policy at a regularly scheduled meeting. Lawyers from L&E are present at the board meeting. The L&E lawyers explain the objectives and operation of the policy to the board, noting that the policy is constructed with clear prescriptions and proscriptions to best ensure that the behavior of directors, officers, employees, and other agents of DEL Corp. remains well within the bounds of the law (which often can be quite complex in substance and in practical application)[13] as a means of protecting both those individuals and DEL Corp. from liability. The board approves and adopts the securities trading policy after due discussion and deliberation. Among other things, the policy prohibits directors, officers, employees, and other agents of DEL Corp. from trading in DEL Corp.'s securities unless certain requirements are met, and from disclosing material nonpublic information about DEL Corp. and its operations and other activities to those without a need to know the information (including DEL Corp.'s advisors and other agents). The policy requires each director, officer, employee, and agent to sign an annual acknowledgement of his or her understanding of and compliance with the policy. A designated employee of DEL Corp. monitors compliance with the acknowledgement requirement.

A few years after approval and adoption of the securities trading policy, L&E represents DEL Corp. in a financing transaction with another firm. Several months after the transaction closes, DEL Corp. receives a letter of inquiry from the Financial Industry Regulatory Authority, Inc. ("FINRA").[14] The letter includes a list of names and asks whether DEL Corp.'s principals and advisors know anyone on the list. A similar letter follows from the SEC. The letters also request that DEL Corp. voluntarily produce certain documents in connection with the inquiries. DEL Corp. asks L&E to assist it in responding to the letters of inquiry and complying with the document production requests.

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13. *See, e.g.*, Joan MacLeod Heminway, *Just Do It! Specific Rulemaking on Materiality Guidance in Insider Trading*, 72 LA. L. REV. 999, 1016 (2012) ("Insider trading compliance plans . . . are . . . crafted to be within the range of legal compliance.").

14. FINRA has assumed responsibility for insider trading surveillance, investigation and enforcement with respect to equity securities listed with, among other markets, the NASDAQ Stock Market. *See* Program for Allocation of Regulatory Responsibilities Pursuant to Rule 17d-2; Notice of Filing & Order Approving & Declaring Effective an Amendment to the Plan for the Allocation of Regulatory Responsibilities Among Bats Exch., Inc., Bats Y-Exchange, Inc., Chicago Bd. Options Exch., Inc., Chicago Stock Exch., Inc., Edga Exch., Inc., Edgx Exch., Inc., Fin. Indus. Regulatory Auth., Inc., Nasdaq Omx Bx, Inc., Nasdaq Omx Phlx, Release No. 65991 (Dec. 16, 2011).

The names on the lists in the letters do not, for the most part, look familiar to L&E. However, in the course of the document production, an attorney for L&E discovers a page from the desk calendar of the Chief Executive Officer ("CEO") of DEL Corp. that proves to be significant. Specifically, the calendar page for the day before the public announcement of the financing includes the following notations:

Call:

[name of DEL Corp. division general manager]
[name of DEL Corp. division general manager]
[name of DEL Corp. division general manager]
[name of DEL Corp. division general manager]

[name of audit partner]
[name of HR firm principal]
[name unfamiliar to the reviewing attorney]

re: deal

The attorney reviewing the calendar page helped write the securities trading policy, was part of the team that presented the policy to DEL Corp.'s board of directors, and worked on the financing transaction. She evaluated the list of names and quickly determined that the names she recognized on the list all had a possible need to know about the impending transaction the day before it was announced. She confirmed that assessment with DEL Corp.'s CEO.

She then asked the CEO who the unfamiliar name was at the bottom of the page, and what her relationship was to the financing. The CEO replied that the last name on the page was a friend who was not involved

in the financing. He went on to offer, in response to further questioning, that he had in fact called that friend the day before the financing was publicly announced "just to let her know, because she's a supportive friend," given that the transaction was a rather significant accomplishment for the CEO and for DEL Corp.

The attorney—surprised (to say the least)—noted that the communication between the CEO and the friend violated the terms of DEL Corp.'s securities trading policy and could be a basis for insider trading enforcement against both the CEO and DEL Corp.[15] The CEO—perhaps a bit less surprised, but concerned—quickly dismissed any connection between his communication with his friend and any unlawful conduct, asserting that the friend would never use that information to trade or share the information with others. Yet, as additional facts would later reveal, the friend did, in fact, trade in DEL Corp.'s common stock based on the information conveyed to her that day by the CEO.

Ultimately, the friend and the CEO consented to the entry of a permanent injunction against them that restrained and enjoined them from committing further violations of Section 10(b) and Rule 10b-5. The SEC ordered the friend to disgorge an amount equal to her illegal trading profits and prejudgment interest on those profits and imposed financial penalties on both the friend and the CEO. The SEC made the resulting consent decree public through a press release, and local papers covered the story. As a result, the standings of DEL Corp. and the CEO in the local community were negatively affected (at least in the short term), although the SEC never pursued an enforcement action against DEL Corp. relating to the matter.

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15. Section 21A of the 1934 Act authorizes the SEC to bring enforcement actions against both violators of insider trading prohibitions and those who control them.

> Whenever it shall appear to the Commission that any person has violated any provision of this chapter or the rules or regulations thereunder by purchasing or selling a security . . . while in possession of material, nonpublic information in, or has violated any such provision by communicating such information in connection with, a transaction on or through the facilities of a national securities exchange or from or through a broker or dealer, . . . the Commission —
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> (A) may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by the person who committed such violation; and
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> (B)may . . . bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by a person who, at the time of the violation, directly or indirectly controlled the person who committed such violation.

15 U.S.C. § 78u-1(a)(1) (2012).

This story—at the intersection of law, ethics, and compliance—is sobering. But it is familiar to many corporate legal advisors. Although the actions of DEL Corp.'s CEO did not subject DEL Corp. to legal action, DEL Corp. did incur legal expenses and sustain reputational damage. The CEO suffered legal, financial, and reputational consequences, although he did not admit liability and a court never adjudicated the legality of his conduct. The public trading price of DEL Corp.'s common stock declined significantly after the public announcement of the consent decree. DEL Corp.'s business relationships and the CEO's ability to generate those business relationships may have been compromised, and DEL Corp.'s securities trading policy and overall compliance plan—designed to protect both the firm and those working for it from legal and ethical missteps—had failed. Diligent counsel to businesses faced with facts similar to these must (and do) ask themselves why this type of noncompliance occurs and whether there was anything they could have done differently to avoid these undesired results.

With those thoughts in mind, this short article reflects on the reckless noncompliant business client and its principals—a client like DEL Corp. with managers like the CEO. Executives like the CEO do not set out to engage in misconduct or violate the law. What, then, prompts or influences the principals of a firm that is represented zealously by competent legal counsel to part ways with the letter or spirit of that counsel's advice in a reckless manner? What factors may play a role? Perhaps firm management fails to fully understand the advice the lawyer has given. Maybe those who direct the firm's activities lack respect for legal or ethical compliance. Alternatively, the firm's leaders may be affected by cognitive biases or other personal or group attributes that dictate their managerial decisions and actions.

To explore these possibilities, the article proceeds by offering brief observations on the potential contribution of each of these factors to managerial noncompliance and, in each case, assessing whether lawyering has the potential to make an impact. Specifically: Part II addresses client comprehension; Part III tackles respect for legal and ethical advice, mandates, and concerns; and Part IV focuses on behavioral psychology considerations. A brief conclusion follows in Part V. The DEL Corp. story is referenced at various junctures to exemplify or illustrate certain points.

II. LACK OF ADEQUATE UNDERSTANDING AS A FACTOR IN LEGAL NONCOMPLIANCE

When a business firm or its principals fail to comply with law, it seems relevant (if not obvious) to ask whether the individuals who are charged with assuring firm or personal compliance possessed sufficient knowledge to avoid noncompliance. A lack of understanding of the law may prevent an executive considering a course of action from properly assessing the liability risk for herself and for the firm.[16] Negligence or reckless malfeasance may result.

Laws applicable in the business context (as in other contexts) can be appreciably complex. Legal advisors to business firms and their principals are charged with translating that complexity into guidance to firm management in a variety of advisory contexts[17]—e.g., board meetings, communications with officers and employees, governance and business policies, client memoranda, opinion letters, and transactional legal drafting. "[C]omplex legal environments, coupled with complex business conduct carried out amidst these environments, can produce considerable compliance planning difficulty and legal uncertainty."[18]

For example, the introductory tale relating to DEL Corp.[19] involves executive officer conduct that engages insider trading enforcement. Firms with publicly traded securities tend to proactively engage in compliance activities to protect themselves and their employees against potential liability relating to securities trading activities, including insider trading.[20] These activities typically include (as they did for DEL Corp.[21]) the adoption of a securities trading policy as part of the firm's overall legal compliance program.[22]

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16. *Cf.* Richard S. Gruner, *Lean Law Compliance: Confronting and Overcoming Legal Uncertainty in Business Enterprises and Other Complex Organizations*, 11 N.Y.U. J.L. & BUS. 247, 260 (2014) ("[I]mperfect perceptions of legal requirements and related company actions can produce large gaps in compliance planning capabilities and create associated legal uncertainties."); Jeff Zalesin, *How to Explain Complex Capital Markets Issues to A Client*, LAW360 (Jan. 7, 2016, 6:03 PM EST) ("[A]n under-informed client could end up damaging the transaction or stumbling into a new source of liability.").

17. Zalesin, *supra* note 16.

18. Gruner, *supra* note 16, at 259.

19. *See supra* Part I.

20. *See supra* notes 5–9 and accompanying text.

21. *See supra* Part I.

22. *See* Jeffrey A. Fiarman & Kenneth B. Wallach, 3 SUCCESSFUL PARTNERING BETWEEN INSIDE AND OUTSIDE COUNSEL § 52:70, 2015 ed. ("Although it does not absolve an employee from being subject to Rule 10b-5, practically all publicly-traded companies have adopted a securities trading policy for their respective directors, officers and employees which require their employees not to trade in the securities of the company if they are in possession of material, nonpublic information."); Jay A. Dubow & John

In general, a firm's securities trading policy establishes policies and procedures relating to management (director, officer, partner, etc.) and employee trading in securities of the firm or securities of other business entities with whom the firm may be involved (depending on the firm's business).[23] Public companies,[24] broker/dealers and other financial intermediaries,[25] law firms,[26] and accounting firms[27] all typically have securities trading policies covering insider trading. In each case, these policies are designed to give clear guidance and (as L&E noted in its board presentation for DEL Corp.[28]) ensure that those who act in accordance with the policy are conducting their activities within the bounds of the law.[29]

Achieving the aspired-for clarity in a securities trading policy is challenging, however. The law of insider trading is complex, and reducing its component parts to unambiguous client proscriptions and prescriptions often seems like an illusory goal.[30] Concepts that are unclear or unsettled in U.S. insider trading law under Section 10(b) and Rule 10b-5 (including, for example, materiality and scienter[31]) are

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Shasanmi, *The Importance of Having and Following A Strong Public Company Insider Trading Policy*, BUS. L. TODAY, October 2011, at 1, 3 ("Companies should institute policies governing trading of their securities by officers, directors, employees, and others with inside information (insiders), targeted at preventing trades at times when insiders may be in possession of material nonpublic information.").

23. *Id.*

24. *See, e.g.*, Steinberg & Fletcher, *supra* note 10, at 1828-30; Dubow & Shasanmi, *supra* note 22.

25. *See, e.g.*, 15 U.S.C. § 78o(g) (2012); *Insider Trading Compliance Programs*, 28 No. 3 CORP. COUNS. QUARTERLY ART. 5 (July 2012); Ted Kamman & Rory T. Hood, *With the Spotlight on the Financial Crisis, Regulatory Loopholes, and Hedge Funds, How Should Hedge Funds Comply with the Insider Trading Laws?*, 2009 COLUM. BUS. L. REV. 357, 408–39 (2009).

26. *See, e.g.*, Harvey L. Pitt et al., *Law Firm Policies Regarding Insider Trading and Confidentiality*, 47 BUS. LAW. 235 (1991); Steinberg & Fletcher, *supra* note 10, at 1800–28.

27. Steinberg & Fletcher, *supra* note 10, at 1794–1800.

28. *See supra* Part I.

29. *See supra* note 13 and accompanying text.

30. *See* Gruner, *supra* note 16, at 261–65 (describing the sources of uncertainty in insider trading law that confound successful legal compliance efforts).

31. *See, e.g.*, Anderson, *Paradox*, *supra* note 10, at 287–88 ("[I]t is generally understood that issuers' employees violate the law against insider trading when they seek to benefit by trading (or tipping) on the basis of material nonpublic information in violation of some 'fiduciary or other similar relation of trust and confidence.' . . . But . . . crucial elements of this definition (e.g., materiality . . . and mental state) remain uncertain."); Stephen J. Crimmins, *Insider Trading: Where Is the Line?*, 2013 COLUM. BUS. L. REV. 330, 355 (2013) ("[A]s insider trading liability theories become more exotic, . . . there may be some question as to the ability of ordinary retail investors to engage in the increasingly sophisticated duty, materiality, and scienter analyses needed to determine

especially difficult to convey.[32] Even experienced lawyers struggle with this task. It is important to note that securities trading policies have certain standard terms and provisions,[33] but they are customized to best insure compliance for each firm and for specific constituents within the firm.[34] The better the drafter knows the firm, the more customized the policy can be. Yet, in many cases, in-house counsel (who should know the firm best) may be overburdened or may not have the expertise or experience to draft a tailored, substantively comprehensive securities trading policy. Accordingly, outside counsel (who may not know the firm as well) often are called upon to draft securities trading policies for their public company clients.[35] In these circumstances, close communication between a firm's outside and in-house counsel can be critical to the construction of an appropriate securities trading policy for the firm—one that is both suitably protective and well understood by those tasked with compliance.

Understanding and complying with a securities trading policy at its adoption is just the beginning, however. It is in the firm's ongoing operations that the suitability and clarity of the policy are tested. For example, the CEO in the DEL Corp. story[36] may well have understood the compliance policy at the time the board of directors adopted it. But he may not have comprehended its applicability in the context of his communications with others on the day before the announcement of the

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whether a particular contemplated trade would violate the law."); Joan MacLeod Heminway, *Martha Stewart and the Forbidden Fruit: A New Story of Eve*, 2009 MICH. ST. L. REV. 1017, 1032 (2009) (noting that two of "my favorite unclear aspects of U.S. insider trading doctrine under current law" are materiality and scienter).

32. *See* Anderson, *Paradox*, *supra* note 10, at 287 ("[I]n the absence of any clear legal definition of insider trading, vagueness, uncertainty, and controversy surround the question of precisely what conduct is proscribed by the law. This state of affairs places issuers in an awkward position. . . . [H]ow can issuers implement policies to reliably prevent conduct that is not defined with any specificity?").

33. *See id.* ("There are a number of insider trading control mechanisms employed by issuers; they include (1) a published ban on any trading in an issuer's shares based on material nonpublic information (i.e., self-policing), (2) requiring preclearance for trading, and (3) the imposition of 'blackout periods.'") (footnotes omitted).

34. *See, e.g.*, Dubow & Shasanmi, *supra* note 22, at 3 ("Policies and procedures are not one-size fits all and covered entities should develop individual policies and procedures that are tailored to their specific operation, industry and employee base."); Steinberg & Fletcher, *supra* note 10, at 1832 ("The policy for high-level officials should provide a more detailed treatment of the basis for prohibitions on insider trading than the policy provided to all employees. For example, the policy may provide examples that such officials will be more likely to encounter than the average employee.").

35. *See* Fiarman & Wallach, *supra* note 22, at § 52:65 (recommending seeking the advice of outside counsel regarding securities law compliance).

36. *See supra* Part I.

financing transaction. By the time the financing transaction occurred, several years had passed. Although the CEO was required to acknowledge his understanding and compliance with the securities trading policy on an annual basis, his actual comprehension of the policy is only tested in context.

The overall success of a securities trading policy depends not only on a clear, comprehensible, bespoke policy, but also on a well-executed, ongoing plan for ensuring that the carefully constructed terms and provisions of the policy are observed in practice.[37] Reflecting on the DEL Corp. story,[38] it is likely that an annual acknowledgement, while necessary, is insufficient to ensure compliance with a securities trading (or other similarly complex) policy. Additional means of identifying and closing gaps in understanding (including, for example, specialized contextual training or communications[39]) may be required.

III. LACK OF RESPECT FOR LEGAL AND ETHICAL ADVICE, MANDATES, AND CONCERNS

In my 15 years as a full-time business law practitioner, I represented a number of clients managed by people who somewhat openly expressed negative views on—even disdain for—legal rules and the lawyering task, as well as basic tenets of business ethics.[40] I am not alone. Others also

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37. *See* Pamela Bucy Pierson & Anthony A. Joseph, *Creating an Effective Corporate Compliance Plan: Part II*, 72 ALA. L. REV. 284 (2011):

> An effective corporate compliance plan consists of steps taken by a business to inform its employees, executives and directors about the laws that apply to them when executing their business duties; to encourage law-abiding behavior by its personnel; to establish protocols for detecting as early as possible any violations of the law committed within the business; and to deal appropriately with any violations that may occur.

Id.; *Insider Trading Compliance Programs*, *supra* note 25 ("Corporate counsel also can assist the company by disseminating the insider trading policy, educating corporate insiders of its procedures, and administering the policy once it is implemented.").

38. *See supra* Part I.

39. *See, e.g.*, Pierson & Joseph, *supra* note 37, at 286:

> Compliance training should be provided for all personnel and, in some instances, third parties who work with a company. . . . Because people learn in different ways, effective compliance training should be presented through a variety of methods: oral presentations, written materials, interactive and video sessions, role-playing, demonstrations, and question-and-answer sessions.

Id. A recent study finds that ethics education may improve the accessibility of ethical dimensions of behavior. *See* Kurt Wurthmann, *A Social Cognitive Perspective on the Relationships Between Ethics Education, Moral Attentiveness, and PRESOR*, 114 J. BUS. ETHICS 131 (2013).

40. The concept of business ethics may require definition:

have observed this state of affairs.[41] Despite legal counsel's best intentions and business-enabling conduct, a business client's management may view the law, the lawyers bound to uphold it, or applicable ethical principles as impediments to business—friction in the gears of commerce.[42]

Disrespect for the law, lawyers, and business ethics may result in irresponsible business conduct—behavior that evidences a reckless disregard for legal and ethical compliance. A business manager's calculus of legal and ethical compliance benefits and costs becomes skewed; management personnel may fail to appreciate legal or ethical

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> Ethics in business is basically no different from ethics in policing, rocket science, or ordinary everyday life. While there may be particular ethical problems typical of the business and financial world, the most important part of ethics is universal: be honest, do not cheat, be trustworthy, be prudent, be concerned about the well-being of others, and so forth.

James G. Murphy, *People in Business: Context and Character*, *in* LEADERSHIP AND BUSINESS ETHICS 117, 124 (Gabriel Flynn, ed. 2008). Although some professions (including, e.g., law) have codified rules of professional responsibility that provide a framework for key ethical conduct, business ethics are defined in a less structured way:

> There is no special code of business ethics; rather, there are questions and dilemmas about remuneration, whistle-blowing, product safety and so on, which arise mainly in the course of business activity, but which can be dealt with in terms of moral principles. And there are values which we intuitively recognise as such. Honesty, reliability, just and fair dealing are recognised as correct behaviour, just as lying, cheating, stealing, cowardice and irresponsibility are recognised as incorrect behaviour. Breaking agreements, treating people unjustly, telling lies, taking more than one's due are wrong – in business as in any other aspect of life.

David Smith & Louise Drudy, *Corporate Culture and Organisational Ethics*, *in* LEADERSHIP AND BUSINESS ETHICS, *supra*, at 165, 168. Ethical business activities may include legal compliance, but they are not limited to legally compliance conduct:

> An ethic of law-observance is not enough, and takes no imagination. The drawing-out or explication of an ethic that would be in some way admirable to both people in business and those in other walks of life, yet clearly grounded in business experience, should be the goal of . . . ongoing dialogue.

Murphy, *supra*, at 129.

41. *See, e.g.*, Murphy, *supra* note 40, at 127 (noting that business participants may "dismiss ethics as soft-hearted and therefore irrelevant to their world.").

42. *See, e.g.*, Craig D. Galli, *A Compliance Crisis Is a Terrible Thing to Waste: Counsel's Role to Enhance Corporate Culture*, 30 NAT. RES. & ENV'T 1, 3 (Winter 2016):

> The dysfunctional compliance approach of some companies can be best described as a pervasive attitude of defiance. . . . [D]isdain for regulators and governing regulations may be palpable at every organizational level. . . . One commentator described companies with a pervasive disrespect for the law and ethical standards as a Wild West "Yahoo Culture."

Id. (Citations omitted).

constraints on their business-related activities.[43] Illegal or unethical conduct may result. In short, business actors must care about compliance with legal and ethical precepts if they are to properly prioritize them in their decision-making processes and activities and avoid the penalties associated with failed compliance.

Although much has been written about this in the past 15 years (especially since public revelations of financial and other business fraud at and involving Enron Corporation and other public companies at the outset of the new millennium), the phenomenon is not new. More than a quarter of a century ago, one commentator observed that:

> Many of our corporate giants reap substantial profits from a callous disregard of their highly proclaimed interest in the consumer, the public, and the environment. Likewise, many flaunt the laws of the very government of the United States that has provided them the freedom under which capitalism can operate. . . [I]t is rare that a top corporate executive condemns unethical corporate practices or even gross violations of law in the corporate world.[44]

The extent to which firm management disregards legal or ethical requirements as unnecessary or counterproductive to the profitable conduct of business may be debated. But the phenomenon has been observed and studied.

How might all of this relate to our insider trading scenario at DEL Corp.?[45] The conduct of DEL Corp.'s CEO may be understood as a manifestation of his attitude toward insider trading law, business lawyers, ethical business practices, or the legal and ethical compliance process. Accordingly, he may have engaged in a faulty cost-benefit

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43. Adam Smith, often cited for (among other things) his advocacy of free-market capitalism in the pursuit of self-interest, understood that legal and ethical considerations factor into business conduct:

> Smith states very clearly, people should work to advance their own interests. "Every man . . . is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men." But where the ellipses appear in the above quotation, he adds the constraint, seldom quoted . . . "as long as he does not violate the laws of justice." That means justice considerations are the limit to any self-interested pursuit.

Ronald Duska & Julie Anne Ragatz, *How Losing Soul Leads to Ethical Corruption in Business*, *in* LEADERSHIP AND BUSINESS ETHICS, at 151, 158 (footnote omitted).

44. MARSHALL BARRON CLINARD, CORPORATE CORRUPTION: THE ABUSE OF POWER 161 (1990).

45. *See supra* Part I.

analysis when he disclosed information about the financing transaction to his friend. He may have discounted the importance of insider trading law, the advice of the firm's lawyers regarding the need for strict and sustained compliance, or the significance of related ethical issues. Moreover, he may have depreciated the value of his role in ensuring DEL Corp.'s overall legal and ethical compliance. As a result, the CEO may have failed to properly comprehend the extent to which his conduct imperiled both himself and DEL Corp. It is important to note in this regard that, when questioned about the inappropriate disclosures he made to his friend, the CEO expressed confidence that she would not use the information about the transaction to trade in DEL Corp.'s securities or tip others who might do the same.

Commentators have suggested a number of approaches to combating management contempt for—or indifference to—business law, lawyers, and ethics. Among the recommendations: tougher, targeted legal enforcement;[46] enhanced education and training;[47] and the institution of governance, reporting, and communication rules designed to better ensure legal and ethical compliance.[48] If business managers (like the CEO in the DEL Corp. story[49]) were better informed about and more frequently reminded of the policy rationale for U.S. insider trading regulation or at least the justification for the key elements of the firm's securities trading policy, they may not only understand, but also prioritize and value compliance with insider trading regulation. Moreover, a business entity like DEL Corp. is well advised to assess the completeness and effectiveness of its compliance systems and processes and, if and as necessary, introduce new organizational structures and mechanisms to enhance management respect for and attentiveness to legal considerations, legal counsel, and ethical principles.

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46. *See, e.g.*, Clinard, *supra* note 44 ("Stronger and more effective enforcement of government relations may well be the best, and perhaps the only, recourse left to protect our citizens and, fundamentally, our capitalist system.").

47. *See, e.g.*, Duska & Ragatz, *supra* note 43, at 158–60 (focusing on business school education in this regard).

48. *See, e.g.*, David Smith & Louise Drudy, *Corporate Culture and Organisational Ethics*, *in* LEADERSHIP AND BUSINESS ETHICS at 170–71 (describing representative governance attributes in the healthcare industry); Leonard Bucklin, *More Preaching, Fewer Rules: A Process for the Corporate Lawyer's Maintenance of Corporate Ethics*, 35 OHIO N.U. L. REV. 887, 895 (2009) (suggesting that integrity in the business associations setting may be enhanced through improved communication among constituents); Sefa Hayibor & David M. Wasieleski, *Effects of the Use of the Availability Heuristic on Ethical Decision-Making in Organizations*, 84 J. BUS. ETHICS 151 (2009) (suggesting that increasing the availability of information about, e.g., the consequences of unethical conduct may decrease the probability of unethical behavior).

49. *See supra* Part I.

More broadly, disrespect or contempt for law, lawyers and ethics may be seen as a sign of a dysfunctional corporate culture.[50] Accordingly, other measures to enhance corporate culture also may be successful in preventing reckless noncompliance. Legal counsel can contribute meaningfully to efforts geared at enhancing corporate culture.[51]

IV. BEHAVIORAL PSYCHOLOGY CONSIDERATIONS

Research from behavioral psychology has been used to explain and predict the conduct of firm management in a variety of circumstances. Commentators have applied this research to make salient observations about the behavioral biases, heuristics, and other cognitive impairments of corporate directors and executives in the C-suite. This research and commentary offer an additional possible explanation for reckless conduct like that exhibited by the CEO in the DEL Corp. story.[52] While a complete survey of the relevant literature on human behavior is beyond the scope of this article, a few key elements of that literature resonate with common experience and provide valuable touchstones.

Most importantly, both anecdotal and empirical information reveals that decision-makers may over-estimate their self-importance and exhibit undue self-assurance in their judgments. This overconfidence is a commonly observed cognitive bias:

> Studies have shown that high percentages of people believe they are better drivers, better teachers, better eyewitnesses, better auditors, and on and on, than their peers. Students, psychologists, CIA agents, engineers, stock analysts, financial analysts, investment bankers, investors, and many other categories of people have been studied and shown to tend toward irrational confidence in the accuracy of their decisions. . . . [P]eople's overconfidence in their own decision making extends to their ethical judgments. People tend to believe not only that they are above average in driving and teaching but also that they are more honest and fair-minded than both their competitors and their peers.[53]

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50. *See* Galli, *supra* note 42, at 3.

51. *Id.* at 4–5 (identifying five ways in which legal counsel can help a business client improve its culture).

52. *See supra* Part I.

53. Robert A. Prentice, *Ethical Decision Making: More Needed Than Good Intentions*, 63 FIN. ANALYSTS J. 17, 20 (2011).

Overconfidence may result in inadequate consideration of the legal or ethical ramifications of, or risks associated with, proposed conduct or an inaccurate assessment of the probability that those ramifications or risks may occur.[54]

Specifically, when making decisions with legal or ethical components, the overconfidence bias may manifest in a belief that, because one is a person of integrity, one always takes the moral course of action.[55] The predictable result is decreased diligence in thought and action as a precursor to decision making. This unquestioning approach may increase the likelihood of illegal or unethical conduct.

Along similar lines, executives may exhibit an optimism bias.[56] They may give undue credence to a favorable view or outcome in their decision-making. As one prominent author on the subject notes, "This overoptimism may be evolutionarily beneficial . . . but irrational optimism can lead to systematic errors in decision making, and in some circumstances, it can induce unethical conduct."[57]

A 2011 article for the American Bar Association's *Business Law Today* describes a relevant manifestation of the optimism bias in insider-trading contexts like the one involving DEL Corp.'s CEO:[58]

> Most people's natural tendencies make them inclined to believe the best about people, especially those with whom they are closest and who they trust the most. Ironically, because the showing of a close, personal relationship is frequently sufficient to show the intent to convey a benefit, friends and family members pose the greatest potential risk to corporate insiders

54. Professor Cass Sunstein has labeled the tendency to ignore probability assessments in certain risk analyses "probability neglect." *See* Cass R. Sunstein, *Probability Neglect: Emotions, Worst Cases, and Law*, 112 YALE L.J. 61, 63 (2002) ("When people neglect probability they may . . . treat some risks as if they were nonexistent, even though the likelihood of harm, over a lifetime, is far from trivial.").

55. *See* Prentice, *supra* note 53, at 20 ("Overconfidence in their own moral compass often leads people to make decisions that have significant ethical implications without engaging in any serious reflection. They 'know' that they are good people and are confident in their instinctive judgments.").

56. *See* Tali Sharot, *The Optimism Bias*, 21 CURRENT BIOLOGY R941, R944 (2011) ("[O]ptimism has been linked to achievement in education, business, sport and electoral politics.").

57. Prentice, *supra* note 53, at 20. *See also* Sharot, *supra* note 56, at R944 (noting the positive adaptive effects of optimism bias, while at the same time cautioning that "[u]nderestimating risk may reduce precautionary behaviour . . . . It could potentially promote harmful behaviours . . . due to the optimistic assumptions that unwanted future outcomes . . . are unlikely to materialize and that positive future outcomes . . . are.").

58. *See supra* Part I.

> and service providers who confide confidential corporate information in them.[59]

An insider may be less guarded in sharing material nonpublic information with family members, friends, and other trusted people in his or her sphere of influence (e.g., financial advisors, personal accountants, and other professional), resulting in reckless violations of Section 10(b) and Rule 10b-5.

DEL Corp.'s CEO[60] may well have been both overconfident in his moral character and overoptimistic in his assessment of the legal and ethical effects of disclosing information the forthcoming DEL Corp. financing with his friend. The path to combatting overconfidence and overoptimism is somewhat unclear. Ensuring the CEO receives information that contradicts the CEO's overly confident and overly optimistic assessments intuitively should result in better decision-making,[61] but studies show that may not in fact always be the case. In particular, although researchers recommend informational solutions to mitigate overconfidence,[62] it may be difficult to overcome optimism bias with counterfactual information.[63]

V. CONCLUSION

When a business lawyer provides information, guidance, recommendations, and advice to a client, the lawyer facilitates legal—and often ethical—compliance. This is key to the lawyer's task as an advisor, as established under applicable rules of professional

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59. Dixie L. Johnson & Robert Greffenius, *Insider Trading by Friends and Family: When the SEC Alleges Tipping*, BUS. L. TODAY (Aug. 18 2011), *available at* http://apps.americanbar.org/buslaw/blt/content/2011/08/article-johnson-greffenius.shtml.

60. *See supra* Part I.

61. *See, e.g.*, MICHAEL A BISHOP & J. D. TROUT, EPISTEMOLOGY AND THE PSYCHOLOGY OF HUMAN JUDGMENT 151–52 (2005) (describing the "consider-the-opposite" de-biasing strategy); STEPHEN P. ROBBINS, DECIDE AND CONQUER: THE ULTIMATE GUIDE FOR IMPROVING YOUR DECISION MAKING 174–75 (2d ed. 2015) ("When we overtly consider various ways we could be wrong, we challenge our tendencies to think we're smarter than we actually are.").

62. *See, e.g.*, Andrew L. Zacharakis & Dean A. Shepherd, *The Nature of Information and Overconfidence on Venture Capitalists' Decision Making*, 16 J. BUS. VENTURING 311, 326 (2001) (proposing "the use of counterfactual thinking, the 'humbling effect,' and decision aids" for this purpose).

63. *See, e.g.*, Sharot, *supra* note 56, at R943 ("[A]n optimism bias is maintained in the face of disconfirming evidence because people update their beliefs more in response to positive information about the future than to negative information about the future").

responsibility.[64] A lawyer owes his or her client important duties[65] and must perform the services rendered competently, promptly, and diligently. [66] In general, the lawyer "should demonstrate respect for the legal system and for those who serve it, including judges, other lawyers and public officials."[67]

In addressing compliance concerns, business entity counsel (in-house and outside) can, should, and do assist their business entity clients in risk assessment and management in the context of their representation.[68] "The 'conception of the lawyer as a promoter of corporate compliance with law emanates from the basic values of the legal profession.'"[69] Customized, well-drafted policies as part of a comprehensive compliance program are essential to that effort.

Compliance policies and programs, taken alone, however, may be insufficient to the task.[70] Even a compliance policy constructed with the

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64. *See, e.g.*, MODEL RULES OF PROF'L CONDUCT pmbl. 2 (AM. BAR ASS'N 2013) ("As advisor, a lawyer provides a client with an informed understanding of the client's legal rights and obligations and explains their practical implications."); *id.* at pmbl. 9 (noting "the lawyer's obligation zealously to protect and pursue a client's legitimate interests, within the bounds of the law").

65. *See, e.g., id.* at pmbl. 4 ("A lawyer should maintain communication with a client concerning the representation. A lawyer should keep in confidence information relating to representation of a client except so far as disclosure is required or permitted by the Rules of Professional Conduct or other law"); *id.* at r. 1.1 ("A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation."); *id.* r. 1.3 ("A lawyer shall act with reasonable diligence and promptness in representing a client."); *id.* at r. 1.6 (regarding the confidentiality of "information relating to the representation").

66. *Id.* at pmbl. 4 ("In all professional functions a lawyer should be competent, prompt and diligent").

67. *Id.* at pmbl. 5.

68. *See generally* Z. Jill Barclift, *Preventive Law: A Strategy for Internal Corporate Lawyers to Advise Managers of Their Ethical Obligations*, 33 J. LEGAL PROF. 31 (2008) (outlining a proactive approach to corporate counsel's role in compliance and risk management); Tanina Rostain, *General Counsel in the Age of Compliance: Preliminary Findings and New Research Questions*, 21 GEO. J. LEGAL ETHICS 465 (2008) (identifying and describing various risk assessment and management roles of general counsel); Janet Stidman Eveleth, *Life As Corporate Counsel*, MD. B.J., January/February 2004, at 18 (profiling Maryland corporate counsel and noting their role in "ensur[ing] company compliance with all pertinent rules and regulations").

69. Sarah Helene Duggin, *The Pivotal Role of the General Counsel in Promoting Corporate Integrity and Professional Responsibility*, 51 ST. LOUIS U. L.J. 989, 1012 (2007) (*quoting* American Bar Ass'n, Report of American Bar Association Task Force on Corporate Responsibility).

70. *See* Prentice, *supra* note 53, at 19 (noting research findings indicating that corporate codes of conduct cannot overcome the behavioral impact of corporate culture); Linda K. Treviño et al., *Behavioral Ethics in Organizations: A Review*, 32 J.

advice of counsel provided in a manner consistent with obligations of professional responsibility and generally acknowledged best practices may not ensure compliance with applicable law and ethical standards. Said another way, "even the best models for preventing corporate harms cannot insulate a corporation from accidents and mistakes."[71] Legal counsel should ask why and endeavor to close the identified compliance gap.

Based on the motivating story and observations set forth in this article, legal counsel to business entities may want to consider some or all of the following ways to better assure client compliance with applicable legal and ethical rules:

- ☐ Confirm that compliance policies are written in as clear and accessible a manner as possible;[72]
- ☐ Work with the client to develop tailored training programs and communication strategies to enhance understanding and ongoing awareness of the law, the firm's related policies, and the value of law, lawyers, and ethics to the enterprise;[73]
- ☐ Develop and employ customized processes and information targeted at counteracting executive over-confidence and over-optimism;[74]

MANAGEMENT 951, 971 (2006) (observing that "the impact of typical elements of ethics infrastructures, such as corporate codes of ethics, appears to be minimal, at least in isolation from more informal, culturally based and leadership-based efforts to foster ethical behavior").

71. David C. Bauman, *Evaluating Ethical Approaches to Crisis Leadership: Insights from Unintentional Harm Research*, 98 J. BUS. ETHICS 281 (2011).

72. *See* Johnson & Greffenius, *supra* note 59 ("insider trading policies should be clear").

73. *See, e.g.*, CHRISTIAN A. CONRAD, MORALITY AND ECONOMIC CRISIS: ENRON, SUBPRIME AND CO. (Diplomica Verlag, 2010) (discussing the necessity of ethics training); A.K. GAVAI, BUSINESS ETHICS 173 (Himalaya Publishing House, 2010) (arguing that customized ethics training is essential to improve the awareness of ignorant or careless managers); Johnson & Greffenius, *supra* note 59 ("insider trading policies should be . . . frequently circulated, . . . confidential documents should be marked as such and distributed only to those who need to know the information, and . . . clear warnings are issued to people when they receive material nonpublic information from their employer.").

74. For instance, expose executives over time to stories about compliance dilemmas involving similarly situated firm managers that foster discussion about the tendency of directors and officers to minimize or ignore risk because of over-confidence in their own judgment or attributes and overly optimistic perceptions of relevant circumstances or people.

- If personalized solutions are rejected as too costly or otherwise impracticable, suggest generic options as a next-best set of alternatives.[75]

At the core of these recommendations is the idea that an ongoing, routinized, thoughtful, client-focused approach to compliance has the best probability of overcoming the potentially diverse barriers to legal and ethical compliance—e.g., ignorance, disregard for legal or ethical rules (or those who promote or enforce them), and cognitive biases. Legal counsel is not, and cannot be, present for every decision made by firm management in the course of the firm's business or the manager's business-related personal decision making. Accordingly, the lawyer needs to substitute consistent, reliable, robust processes for presence to give the client the best chance of success in achieving more consistent legal and ethical compliance.

Many compliance advocates and commentators also promote using the threat of punishment to encourage compliance.[76] However, traditional behavioral motivations in the form of severe negative ramifications for noncompliance may play a lesser role in guiding conduct that is negligent or reckless than they do in incentivizing the compliance of

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75. For example, wide circulation of a law firm client alert to directors and employees (including officers) may provide accessible information that enhances client understanding and related legal and ethical compliance. A King & Spalding client alert notes, in summarizing, that "insider trading investigations frequently focus on executives and managers who either unintentionally divulged material, nonpublic information or who specifically told someone they were sharing information in confidence" and advises executives to: "[a]void oversharing, even if it boosts your ego or calms your anxiety" and "[i]f you feel you have overshared, make sure to reiterate that the information was divulged in confidence and that it should not be used for trading." King & Spalding, Client Alert, Special Matters & Government Investigations Practice Group, *Friends and Family: Keeping Loved Ones Safe from Insider Trading Temptations*, Dec. 4, 2014, at 6, http://www.kslaw.com/imageserver/KSPublic/library/publication/ca120414b.pdf (Advising the periodic circulation of a similarly relevant current news article or other short public media release among employees may have a similar effect). *See, e.g.*, Peter Siris, *Insider trading is not always high-profile or intentional; it's important for employees to be aware*, N.Y. DAILY NEWS (Apr. 5, 2011), http://www.nydailynews.com/news/money/insider-trading-not-high-profile-intentional-important-employees-aware-article-1.112091.

76. *See, e.g.*, Till Talaulicar, *Corporate Codes of Ethics: Can Punishments Enhance Their Effectiveness?, in* CORPORATE GOVERNANCE AND BUSINESS ETHICS (Alexander Brink, ed. 2011) (discussing the ability to improve compliance with internal disincentives for violation); Treviño et al., *supra* note 70, at 966 (noting studies that indicate "weak sanctions can be worse for ethical behavior than no sanctions at all, in part because the presence of sanctions makes it more likely that individuals will view a decision from within a framework of narrowly business-driven thinking (in contrast to an ethical decision-making framework).").

willful wrongdoers acting in self-interest. Cost-benefit analyses may be less clear and accurate in a negligent or reckless context given the potential presence of some form of impaired cognition. It seems more reasonable that a compliance-positive firm culture—one built on the consistent and persistent encouragement of legal and ethical behavior through understanding and awareness rather than the constant or episodic fear of negative consequences for illegal or unethical conduct via significant penalties—will succeed in minimizing careless or inadvertent violations of legal or ethical principles. That observation notwithstanding, it seems appropriate to note in closing that this is undoubtedly a promising area for continued research and practical innovations.