A PROPOSAL TO ENCOURAGE UP-THE-LADDER REPORTING BY INSULATING IN-HOUSE CORPORATE ATTORNEYS FROM MANAGERIAL POWER

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ABSTRACT

After the 2001 financial collapse of publicly traded Enron Corporation—caused by alleged accounting fraud—the U.S. Congress included Section 307 in the Sarbanes-Oxley Act of 2002 ("Section 307"). Section 307 requires in-house corporate attorneys to report instances of corporate wrongdoing and fraud at their companies "up the ladder" to senior management and the board of directors ("Board"). In certain circumstances, Section 307 also permits in-house counsel to "report out" wrongdoing to the Securities and Exchange Commission ("SEC"). However, when complying with either the "reporting up" or "reporting out" provisions of Section 307, in-house corporate attorneys face possible pushback and retaliation from their senior executive team (including chief executive officers). This is especially true if senior executives are implicated in the wrongdoing. Additionally, given the influence of managerial power over a corporation's legal department with respect to hiring, disciplinary action, and firing, in-house corporate attorneys will be hesitant to act as whistle-blowers and report up or report out instances of corporate wrongdoing.

The current debate on Section 307 centers on whether the provision permitting reporting out to the SEC conflicts with an attorney's duty to keep her corporate employer's information confidential. However, there is less discussion on Section 307's reporting up provision, and how existing managerial power and governance structures discourage in-house corporate attorneys from reporting corporate wrongdoing up the ladder. There is also very little guidance on how corporate attorneys may immunize themselves from retaliation when they report wrongdoing to the very same senior managers that may be involved in the wrongdoing. This article's contribution, therefore, is

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twofold. First, this article will examine how existing managerial and governance structures contribute to the risks that in-house corporate attorneys face when complying with Section 307's reporting up provision. Second, this article proposes a normative, modified reporting structure that requires in-house attorneys to bypass the Chief Executive Officer ("CEO") and report directly to the Board. Our normative model would insulate in-house attorneys from retaliation and pushback from senior management. As such, corporate attorneys should be more willing to report corporate wrongdoing and fraud up the ladder to their company's Board for corrective remedy. This increased reporting, in turn, should enhance corporate transparency and investor protection against fraud.

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I. INTRODUCTION

Each new financial crisis in the United States has led to legislative reforms to address the perceived causes of the crisis.[1] The Wall Street Crash of 1929, for example, led to the Glass-Steagall Banking Act (1933), the Securities Act (1933), and the Securities Exchange Act (1934).[2] After the 2001 financial collapse of Enron and WorldCom,[3] the United States Congress acted once again and "passed the Sarbanes-Oxley Act (SOX) to prevent future financial collapses and restore confidence in U.S. capital markets."[4] With respect to Enron, it was perceived that Enron's in-house corporate attorneys, in collaboration with Enron's external legal counsel, played a role in the company's collapse by "displaying a lack of objective professional advice and oversight."[5] Specifically, Congress was concerned that Enron's in-house and external attorneys failed to report instances of corporate malfeasance and accounting fraud—orchestrated by Enron's senior management—to the SEC.[6] To counter this failure in reporting, Congress added Section 307, a federal whistleblower provision, to SOX.[7]

Section 307 of SOX mandated the SEC to establish rules requiring attorneys practicing before the SEC to report "material violation[s] of securities law or breach[es] of fiduciary duty or similar violation[s]"[8] up the ladder at the client corporation or within their own organization.[9] In certain situations, Section 307 also permits attorneys to "report out" confidential information to the SEC, without their corporate clients' consent.[10] Section 307 "applies to both in-house and outside counsel

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[1] *See infra* notes 2-5.

[2] JOHN C. COFFEE, JR. & HILLARY A. SALE, SECURITIES REGULATION: CASES AND MATERIALS 2-3, 48-49 (11th ed. 2009).

[3] James L. Sonne, *Sarbanes-Oxley Section 307: A Progress Report on How Law Firms and Corporate Legal Departments Are Implementing SEC Attorney Conduct Rules*, 23 GEO. J. LEGAL ETHICS 859, 859 (2010); Simon Romero & Riva D. Atlas, *WorldCom's Collapse*, N.Y. TIMES (July 22, 2002), *archived at* http://perma.cc/XE5N-G8A4.

[4] Sonne, *supra* note 3, at 859.

[5] *Id.*

[6] Thomas G. Bost, *Corporate Lawyers after the Big Quake: The Conceptual Fault Line in the Professional Duty of Confidentiality*, 1 J. BUS., ENTREPRENEURSHIP & L. 335, 336 (2008).

[7] *Id.*

[8] Sarbanes-Oxley Act § 307, 15 U.S.C. § 7245 (2002).

[9] Bost, *supra* note 6, at 336.

[10] *See* Kaveh Noorishad, *The Sarbanes-Oxley Act and In-House Legal Counsel: Suggestions for Viable Compliance*, 18 GEO. J. LEGAL ETHICS, 1041, 1049 (2005) (noting both in-house and outside counsel face the same reporting dilemmas).

appearing and practicing before the SEC."[11] Although Section 307 was enacted in 2002, its relevance to preventing corporate fraud has reemerged today in the aftermath of the recent 2008 financial crisis.[12]

Advocates of Section 307 believe that both the reporting up and reporting out provisions promote corporate transparency and protect the investing public against fraud and corporate malfeasance.[13] Critics however, have largely focused on Section 307's reporting out provision.[14] They argue that corporate attorneys who whistle blow to the SEC against their clients are acting contrary to the fiduciary duties of confidentiality owed to their clients.[15] As such, compliance with Section 307's reporting out provision may expose corporate attorneys to sanctions for violations of state rules of professional conduct that protect client confidentiality,[16] attorney-client privilege,[17] and the work product of attorneys.[18]

However, there has been less discussion of Section 307's reporting up provision and whether corporate attorneys might be discouraged to comply if they face potential retaliation and pushback from senior management—especially if senior management is implicated in the wrongdoing or fraud.[19] This article, therefore, attempts to move beyond the current academic debate pitting Section 307 against attorneys' duties of confidentiality. Instead, this article focuses on two objectives. First, this article opens up a new line of inquiry by examining how existing managerial and governance structures contribute to the risks that in-house corporate attorneys face when complying with Section 307's reporting up-the-ladder provision.[20] Second, this article proposes a

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[11]David Waters, Comment, *The Wisdom of Whistleblowing: The Sarbanes-Oxley Act of 2002 and the "Noisy Withdrawal" Provision*, 34 J. LEGAL PROF. 411, 411 (2010).

[12]*Id.*

[13]*See* Sara B. Smith, Comment, *Sarbanes-Oxley Act, Section 307–The Price of Accountability: How Will Section 307 Affect the Role of the Corporate Attorney?*, 107 W. VA. L. REV. 901, 915 (2005) (noting Section 307 prevents counsel not only from assisting clients in fraudulent practices, but also from pretending that it is unaware of such practices).

[14]*See, e.g.*, Waters, *supra* note 11, at 414-15 (discussing the pros and cons of the "noisy withdrawal").

[15]Bost, *supra* note 6, at 370.

[16]*Id.* at 369-373 (outlining reasons for strong opposition to Section 307 in California, Alabama, Kentucky, Missouri, Montana, and Rhode Island).

[17]*Id.* at 368.

[18]*Id.*

[19]Noorishad, *supra* note 10, at 1051 ("[N]either the Sarbanes-Oxley Act nor the Model Rules adequately discuss how lawyers should conduct themselves when faced with a situation where they must choose between their livelihood and what is ethically correct.") (emphasis omitted).

[20]*See infra* Part III.

modified reporting structure that requires in-house attorneys to bypass the CEO and report directly to the Board.[21] Our normative reporting model would immunize in-house attorneys from retaliation and pushback from the senior management.[22] As such, corporate attorneys would be more willing to report corporate wrongdoing and fraud to their company's Board for corrective remedy.[23] In turn, this should promote the dual policy objectives of fostering corporate transparency and investor protection against fraud.[24]

This article proceeds as follows. Part II first sets out the statutory mechanism of Section 307 and its regulatory companion—SEC Rule 205.[25] Part II then highlights the key doctrinal rationale supporting Section 307 and situates the current academic debate on Section 307. Last, Part II identifies a new line of inquiry focusing on how managerial power might discourage in-house corporate attorneys to act as whistle-blowers under Section 307. Part III undertakes a doctrinal analysis as to why it is difficult for in-house corporate attorneys to act as whistleblowers in the context of the managerial power theory. This article borrows the managerial power theory from the executive compensation debate[26] to explain senior management's power and influence in discouraging in-house attorneys from acting as whistleblowers within their organizations. Part IV provides a proposal for a normative reporting model that is designed to insulate in-house corporate attorneys from pushback and retaliation by their company's senior management. Part V provides concluding remarks.

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[21] *See infra* Part IV.

[22] *See infra* Part IV.

[23] *See infra* Part IV.

[24] *See* Kim T. Vu, Note, *Conscripting Attorneys to Battle Corporate Fraud Without Shields or Armor? Reconsidering Retaliatory Discharge in Light of Sarbanes-Oxley*, 105 MICH. L. REV. 209, 228-29 (2006).

[25] 17 C.F.R. § 205 (2003).

[26] The managerial power theory has been previously applied by academics to explain how managerial power influences excessive executive compensation at publicly traded companies. *See* Lucian Arye Bebchuk et al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 755 (2002) ("Our analysis indicates that managerial power and rent extraction are indeed likely to play a significant role in executive compensation in the United States").

II. BACKGROUND

This section describes both the reporting up and reporting out mechanisms of Section 307 and SEC Rule 205.[27] It also addresses the doctrinal rationale for Section 307,[28] explores the current academic debate, and outlines how this paper seeks to open up a new line of inquiry on Section 307.[29]

A. *Section 307 of the SOX and SEC Rule 205*

Section 307 mandates the SEC to establish:

> "minimum standards of professional conduct for attorneys appearing and practicing" before the SEC, including a rule requiring lawyers with evidence of a "material violation" of law to report that evidence up the ladder, beginning, in the typical case, with the company's chief legal officer and ending with the board of directors if those below did not "appropriately respond."[30]

Section 307 also permits an attorney to disclose confidential corporate information to the SEC without the corporation's consent:

> [if] disclosure is necessary to: (1) prevent the company from committing a material violation likely to cause substantial injury to the financial interest or property of either the company or investors; (2) prevent the company, in an SEC investigation or administrative proceeding, from committing or suborning perjury or perpetrating a fraud upon the SEC; or (3) rectify the consequences of a material violation by the company that has caused, or may cause, substantial injury to the financial interest or property of the company or investors in the furtherance of which the lawyer's services have been used.[31]

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[27] *See infra* Part II.A.
[28] *See infra* Part II.B.
[29] *See infra* Part II.C.
[30] Bost, *supra* note 6, at 336 (quoting 15 U.S.C. § 7245 (2005)).
[31] *Id.* at 353 (summarizing 17 C.F.R. § 205.3(d)(2) (2006)).

Section 307's regulatory companion, SEC Rule 205, reaffirms the dual reporting up and reporting out obligations of Section 307.[32] For instance, SEC Rule 205.3(b)(1) echoes the up the ladder reporting provision of Section 307 by stating:

> If an attorney, appearing and practicing before the [SEC] in the representation of an issuer, becomes aware of evidence of a material violation by the issuer or by any officer, director, employee, or agent of the issuer, the attorney shall report such evidence to the issuer's chief legal officer (or the equivalent thereof) or to both the issuer's chief legal officer and its chief executive officer (or the equivalents thereof) forthwith.[33]

Similarly, the reporting out provision of Section 307 finds regulatory expression as SEC Rule 205.3(d)(2).[34] Rule 205.3(d)(2) permits attorneys practicing before the SEC to disclose to the SEC any corporate wrongdoing to prevent their corporate clients from engaging in a "material violation" or committing "perjury."[35]

B. *Corporate Attorneys as Gatekeepers: A Doctrinal Rationale for Section 307*

Both the reporting up and reporting out provisions require in-house corporate attorneys to carefully balance their statutory and regulatory obligations against their duties of confidentiality to their corporate clients[36] and possible retaliation from senior management.[37]

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[32] *See* Stephen M. Bainbridge, *Corporate Lawyers as Gatekeepers*, 8 SCHOLARLY PERSP. 5, 9 (2012) ("The core of the new rules is a version of the up-the ladder reporting requirement . . . .").

[33] 17 C.F.R. § 205.3(b)(1) (2013).

[34] *See* Bainbridge, *supra* note 32, at 18 n. 21 ("Part 205 permits, but does not require, an attorney to disclose confidential client information to the SEC under specified conditions . . . .").

[35] 17 C.F.R. § 205.3(d)(2) (2013).

[36] *See generally* Cosgrove Law Grp., LLC, *SOX Section 307 and ABA Rule 1.13: Corporate Counsel Caught in the Crosshairs*, SEC. & INV. BLOG (June 16, 2010), *archived at* http://perma.cc/DW24-CMWR (discussing the delicate position lawyers may find themselves facing).

[37] *See* Vu, *supra* note 24, at 212 & n.20 ("[I]t remains unclear whether SOX protects whistleblower-attorneys.").

Such retaliation could include reprimand, demotion, or even loss of employment.[38]

Notwithstanding these potential problems, advocates of Section 307 and SEC Rule 205, have justified their support on their doctrinal belief that in-house corporate attorneys should serve as gatekeepers for their own organizations.[39] In other words, supporters of Section 307 argue that in-house corporate attorneys should function not as advocates, but as gatekeepers for their corporate clients.[40] Professor Coffee of Columbia Law School believes that "gatekeeper obligations" should be imposed on securities attorneys.[41] According to Coffee, "[t]he term 'gatekeeper' . . . describe[s] the independent professionals who serve investors by preparing, verifying, or assessing the disclosures that they receive."[42] These independent professionals include auditors, debt rating agencies, securities analysts, investment bankers, and securities attorneys.[43] Coffee believes that securities attorneys can act as guardians[44] of the capital markets by withholding their consent for completing a transaction desired by their corporate clients.[45]

However, imposing such an onerous gatekeeper obligation on in-house corporate attorneys seems overly burdensome when their continued employment depends on their ability to get transactions completed.[46] Moreover, it is one thing to suggest that an attorney can withhold consent from completing a possible fraudulent transaction,[47] but it is quite another thing to extend the role of a gatekeeper to one that should report out confidential corporate information to the SEC. Indeed,

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[38] *Id.* at 212.

[39] *See* John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1295 (2003) (noting that the SEC "indirectly" imposes gatekeeper obligations on lawyers).

[40] *See id.* at 1296 ("[I]mposing gatekeeper obligations on attorneys is likely neither to chill socially desirable client communications nor to reduce attorneys' influence over their clients, but may actually increase attorneys' leverage over their most intransigent clients.").

[41] *Id.*

[42] *Id. See generally* JOHN C. COFFEE, JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE (2006) (describing the evolution of gatekeepers in the corporate and securities regulation context).

[43] Coffee, *supra* note 39, at 1296-97.

[44] *Id.* at 1295.

[45] *Id.* at 1297.

[46] *See* Bainbridge, *supra* note 32, at 7, 8, 17 n.12 (discussing the reasons why in-house counsel may overlook misconduct of the people who hired them).

[47] Note, *Government Counsel and Their Obligations*, 121 HARV. L. REV. 1409, 1419 (2008) ("The [gatekeeper] attorney can alert others, using the information gleaned from his or her role to involve outside authorities or to warn third parties.").

requiring a corporate attorney to act as a gatekeeper undermines the "traditional role of the lawyer in an adversarial system."[48] In an adversarial system, the attorney's central role is to be a zealous advocate on behalf of her client, especially when the adversary is the government.[49]

Professor Paton of Queen's University in Canada best summarizes the dilemma of in-house corporate attorneys reconciling their dual roles as gatekeepers and advocates:

> The fact of having one client—the corporation or the government—means that an in-house lawyer is particularly vulnerable when there is challenge from within the organization. Telling senior officers "no" to their proposed plans and schemes may be the right legal and ethical answer, but it can bring a particularly high price, especially if the lawyer finds that he or she has to exercise the ultimate professional recourse and withdraw from representation. Losing a major client in a law firm can have significant consequences, to be sure, but withdrawing from your one client as an in-house lawyer equates to a loss of status, income and employment, raising the ethical stakes for in-house practitioners that much further.[50]

Section 307 and SEC Rule 205, therefore, impose a fairly onerous gatekeeper burden on in-house corporate attorneys.[51] As addressed briefly above, corporate attorneys must balance this gatekeeper burden against the duties of confidentiality they owe their corporate clients or corporate employers and possible retaliation from senior management at their own organizations.[52]

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[48]Lorella Nerini Dal Pezzo, Comment, *Reporting Rules for U.S. and International Lawyers Under Sarbanes-Oxley: Exporting an Unfinished Product?*, 3 FLA. INT'L. U. L. REV. 461, 482 (2008).

[49]*Id.*

[50]Paul D. Paton, *Corporate Counsel as Corporate Conscience: Ethics and Integrity in the Post-Enron Era*, 84 REVUE BARREAU CAN. 532, 538 (2005).

[51]*See id.* at 538-39 ("Remaining ethical, independent, and professional in an in-house practice requires a level of personal sacrifice and dissociation from the company or the team not demanded of almost any other corporate player.").

[52]Vu, *supra* note 24, at 212 ("Purportedly, SOX protects all reporting employees from retaliation through the whistleblower provisions under § 806."). However, it is unclear from reading § 307 and § 806 together, if § 806 protections extend to in-house corporate attorneys

C. *Moving Beyond the Current Debate on Section 307*

The current debate on Section 307 focuses on the question of whether the reporting out provision abridges the attorney's duty of confidentiality.[53] The question has yielded two opposing views.[54]

On one side of the debate, defenders of the attorney-client relationship argue attorneys cannot fully represent their clients because clients will be unwilling to engage in full and frank communications if such communications are not protected by confidentiality.[55] The proponents of this view also believe the federal government has encroached on the state's power to regulate attorney conduct through enactment of Section 307 and SEC Rule 205.[56]

For instance, under the rules of professional conduct for every jurisdiction, subject to a number of limited exceptions, attorneys are required to maintain the confidentiality of information they receive from their clients.[57] The rationale for the attorneys' duty of confidentiality to their clients is very clear:

> The lawyer who is the client's counselor exercises independent judgment, renders candid advice, and necessarily engages in a moral discourse with her client. The lawyer's ability to function as a counselor is to a significant degree dependent upon the client's willingness to communicate fully and frankly with her. The foundational assumption of the ethics codes is that the client's trust in the lawyer is a necessary prerequisite to his willingness to engage in full, or at least, adequate self-disclosure. It is in this context that the duty of confidentiality is crucial:

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who report up or out instances of corporate fraud and wrongdoing under § 307. *Id.* at 213 ("[T]he statute does not provide explicit language connecting § 307's whistleblowing obligations with § 806's whistleblower protections.").

[53]*See, e.g.*, Bost, *supra* note 6, at 338-39 (noting that there is a fundamental difference between the reporting duty and the duty of confidentiality).

[54]*See infra* text accompanying notes 55-67.

[55]*See, e.g.*, Coffee, *supra* note 39, at 1302-08.

[56]G. Thomas Stromberg, Jr. & Anna R. Popov, *Lawyer Conduct Rules Under Sarbanes-Oxley & State Bars: Conflicts to Navigate?* 13 (Wash. Legal Found., Working Paper No. 132, 2005), *archived at* http://perma.cc/K84P-NNVH.

[57]Barry R. Temkin, *Lawyers as Whistleblowers Under the Dodd-Frank Wall Street Reform Act, Ethical Conflicts Under the Rules of Professional Conduct and SEC Rules*, 84 N.Y. ST. B.A. J. 10, 12 (2012).

> without it, the client would not trust his lawyer to the extent necessary for effective representation.[58]

By requiring attorneys to act as whistleblowers in violation of client confidentiality, Section 307 purports to regulate attorney conduct.[59] As such, the federal government appears to encroach upon a jurisdictional matter that is typically in the hands of state bar regulators.[60] A number of academic commentators have agreed with this assessment.[61] For instance, Cramton et al. have argued that Section 307 and SEC Rule 205 preempt and reign supreme over state ethics rules.[62] Others have even argued that such federal preemption "is perhaps unconstitutional,"[63] because the "regulations potentially encroach on state regulation of attorney ethics . . . ."[64]

On the other side of the debate, legal commentators, including Coffee, have argued that lawyers should serve as gatekeepers and therefore should comply with the spirit and intent of Section 307.[65] Generally, Section 307 and SOX are intended to promote investor confidence and the integrity of capital markets.[66] As such, in-house corporate attorneys have an equally compelling duty to disclose confidential information when necessary to prevent and expose corporate wrongdoing and fraud.[67]

Rather than resolve the question of whether corporate attorneys breach their duties of confidentiality when complying with Section 307, this article assumes that corporate attorneys do have an obligation to comply with Section 307. The contribution of this article, then, is to

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[58]Bost, *supra* note 6, at 338.

[59]Coffee, Jr., *supra* note 39, at 1293 (noting that Section 307 imposed minimum standards of professional conduct).

[60]Temkin, *supra* note 57, at 12.

[61]*See infra* text accompanying notes 62-64.

[62]Roger C. Cramton et al., *Legal and Ethical Duties of Lawyers after Sarbanes-Oxley*, 49 VILL. L. REV. 725, 788-98 (2004) (exploring whether Section 307 and Rule 205 preempt state laws). *But see* Temkin, *supra* note 57, at 19 (critiquing Cramton et al.).

[63]Temkin, *supra* note 57, at 19.

[64]*Id.* at 14.

[65]Coffee, *supra* note 39, at 1316 ("SEC rules thus offer the best prospect for a relevant, precise response that avoids pointless disparity while clearly notifying securities attorneys that—like it or not—they are gatekeepers.").

[66]*Implementation of the Sarbanes-Oxley Act of 2002: Hearings Before the S. Comm. on Banking, Hous., and Urban Affairs*, 108th Cong. 1 (2003) (statement of William H. Donaldson, Chairman, SEC), *archived at* http://perma.cc/UY5E-MZYP.

[67]*Id.* ("The Act also affects those that play a role in ensuring the integrity of our capital markets, such as . . . attorneys.").

open a new line of inquiry on the impact of managerial power over in-house attorneys and to propose a modified reporting structure to insulate said attorneys from possible retaliation when they report wrongdoing up the ladder within their own organizations.[68]

III. MANAGERIAL POWER AND THE LIMITATIONS OF THE CURRENT REPORTING STRUCTURE FOR IN-HOUSE CORPORATE ATTORNEYS

In the majority of cases, corporate attorneys would be required to report evidence of a material violation up the ladder, "beginning, in the typical case, with the company's chief legal officer and ending with the board of directors if those below did not 'appropriately respond.'"[69] While there are cases where reporting out is an appropriate course of action (for instance, where the Board fails to adequately address evidence of purported fraud),[70] this article focuses solely on the reporting up provision of Section 307.[71]

A. *The Existing Dynamic Between Management and In-House Corporate Counsel*

Corporations have complex and varied organizational structures.[72] Legal departments consist of multiple junior and supervising attorneys[73] reporting up to the Chief Legal Officer ("CLO"), who in turn reports to the CEO.[74] Violations of securities law and fraudulent conduct can occur at virtually any rung of the corporate ladder.[75] In-house counsel occupy a

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[68] *See infra* Part IV.

[69] Bost, *supra* note 6, at 336 (quoting 15 U.S.C. § 7245 (2005)).

[70] *See, e.g.*, Vu, *supra* note 24, at 211-12 ("[A]ttorneys must serve as internal whistleblowers to the corporation, and may voluntarily serve as external whistleblowers to the SEC.").

[71] *See infra* Part IV.

[72] *See Bost*, *supra* note 6, at 350 ("Belying the apparent simplicity of the 'up the ladder' reporting concept, the SEC rules establish a complex, if not byzantine, reporting scheme for lawyers.").

[73] *See id.* (describing categories of attorneys that may be viewed as "appearing and practicing" before the SEC).

[74] *But see id.* at 350-51 (showing that the number of reporting options increases at every rung of the corporate ladder, particularly if a corporation has a qualified legal compliance committee).

[75] *See, e.g.*, FBI, FINANCIAL CRIMES REPORT TO THE PUBLIC FISCAL YEARS 2010-2011 (last visited Sept. 13, 2014) (stating that corporate fraud includes falsification of financial information, insider self-dealing, and obstruction of justice designed to concealed fraudulent

unique position in the company where they can detect fraud occurring at different locations across the overall nexus.[76] Of particular concern is the potential for upper management, including the CEO, to violate securities laws or engage in fraudulent conduct, and the willingness of corporate attorneys to confront their bosses who wield enormous power over the affairs of the corporation.[77]

Both the Enron scandal and the 2008 financial crisis point to the stark reality that upper management has the propensity to engage in such conduct.[78] When managerial malfeasance does occur, the consequences for the corporation and investors are dire.[79] The 2008 financial crisis demonstrates that upper management, especially CEOs, are often motivated by perverse executive compensation incentives to take excessive risks and engage in extreme short-term profit-seeking to bolster the company's current earnings at the expense of its long-term viability.[80] In fact, the literature reveals that as far back as the 1990s, corporate executives would exploit market fluctuations, manipulate earnings, and misrepresent material facts to meet short-term earnings expectations and reap their bonuses.[81]

In a large public corporation, the CEO typically has the power and discretion to hire and fire a wide range of employees, contractors, and consultants.[82] Under most corporate legal frameworks, the Board has almost exclusive jurisdiction over the affairs of the corporation, subject to a limited scope of shareholder rights to elect the Board members and

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practices), *archived at* http://perma.cc/58F5-QDCX.

[76]*See* R. William Ide & William J. Clark, *The Chief Legal Officer's Critical Role in the Compliance Function*, BLOOMBERG BNA (July 1, 2014), *archived at* http://perma.cc/6PYN-985H (noting that in-house counsel educates about legal risks, prevents liabilities, and investigates potential violations).

[77]John Armour & Joseph A. McCahery, *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US* 7-8 (Amsterdam Ctr. L. & Econ., Working Paper No. 2006-07).

[78]*See generally id.* at 1-23; GILLIAN TETT, FOOL'S GOLD: HOW UNRESTRAINED GREED CORRUPTED A DREAM, SHATTERED GLOBAL MARKETS AND UNLEASHED A CATASTROPHE (2010).

[79]*See* Comment, Tien Glaub, *Lessons from Germany: Improving on the U.S. Model for Corporate Governance*, 5 BYU INT'L L. & MGMT. REV. 235, 235 (2009) (describing dire consequences to Enron shareholders).

[80]Sanjai Bhagat & Roberta Romano, *Reforming Financial Executives' Compensation for the Long Term*, *in* RESEARCH HANDBOOK ON EXECUTIVE PAY 136 (Randall S. Thomas & Jennifer G. Hill eds., 2012).

[81]*See* Linda J. Barris, *The Overcompensation Problem: A Collective Approach to Controlling Executive Pay*, 68 IND. L. J. 59, 68 (1992).

[82]Lawrence A. Hamermesh, *Who Let You into the House?*, 2012 WIS. L. REV. 359, 365-66 (2012).

vote on major structural transactions.[83] A defining feature of corporate organization is the lack of influence shareholders have on the operations of the firm.[84] Serving merely an oversight function, the Board delegates management authority to a CEO, who wields enormous power over the corporation's resources and staff.[85]

The CLO is typically handpicked by the CEO and presides over senior supervising attorneys who in turn oversee junior in-house counsel.[86] Although not directly overseeing the legal department, a CEO can certainly exert influence over: legal policy;[87] the actions of individual attorneys;[88] and the tenure of legal personnel or outside legal consultants.[89] The literature reveals that senior management often strategically employs outside firms for particular aspects of a corporation's legal needs,[90] while selectively using in-house counsel for other facets.[91]

Of particular concern is the ability of upper management to use legal professionals strategically to reach a desired outcome in the context of an investigation into misconduct.[92] For instance, management can respond to concerns over material violations brought forward by a senior in-house attorney by hiring outside counsel to investigate.[93] The CEO

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[83]MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 1 (1976).

[84]*See* John Armour et al., *What is Corporate Law?*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 1, 56 (2d ed. 2009) (explaining shareholders exercise only indirect control).

[85]*See* ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 82 (rev. ed. 1968) (noting management can become a self-perpetuating control body).

[86]Kevin Keogh, *A Lawyer's Dilemma: The Impact of Up-The-Ladder Reporting Under Sarbanes-Oxley*, IN-HOUSE BRIEFING (June 2003), *archived at* http://perma.cc/X86Z-7S2U.

[87]Special Comm. on Mgmt. & Org. of the Practice of the Profession, *The Management and Organization of a Corporation's Legal Affairs*, 38 REC. OF THE ASS'N OF THE BAR OF THE CITY OF N.Y. 261, 264 (1983).

[88]*See* Vu, *supra* note 24, at 235 (explaining inherent management control over in-house counsel).

[89]*See id.* at 235-36 (showing management control extends to outside counsel as well).

[90]*See, e.g.*, *Building Successful Relationships between In-House And Outside Counsel*, METRO. CORP. COUNSEL, May 2006, at 46, *archived at* http://perma.cc/WZR9-MEMW.

[91]*See id.*

[92]Bost, *supra* note 6, at 344-45 (noting the significant role that Enron's outside counsel played in downplaying the concerns of Sherron Watkins, an Enron financial executive).

[93]*See* Matteson Ellis, *When to Use Outside Counsel for FCPA Investigations*, CORP. COMPLIANCE INSIGHTS (Feb. 17, 2014), *archived at* http://perma.cc/63GS-PJ35 (noting violations of law, as opposed to internal policy, as well as violations reported by credible, high-ranking whistleblowers may warrant use of outside counsel).

could pick a team of lawyers from a firm he knows would acquiesce to upper management's version of the story and be less likely to flag particular discrepancies.[94] For instance, a law firm that has received millions of dollars in legal work from a company, through its CEO, would be more inclined to help the CEO justify and legitimize the alleged discrepancies, thereby getting their client out of trouble as opposed to confirming his misconduct.[95]

Of equal concern is the ability of upper management to selectively frame the issues surrounding an investigation into a material violation or alleged fraud and influence how an investigation is conducted.[96] In advance of investigating a complaint, management can determine what the issues are, where investigators should look, and whom they should interview.[97] They can enlist an outside firm to investigate a series of transactions or decisions originating in a particular department and limit the scope of the investigation.[98] By controlling the information available to an outside investigating firm, upper management can strategically select which aspects of an alleged violation lawyers should focus on, distorting the outcome in a manner that draws attention away from a particular problem and exonerates management's conduct.[99]

B. *Managerial Power Theory*

While no coherent theory of managerial power exists in the gatekeeper corporate attorney context,[100] much can be borrowed from Bebchuk and Fried's managerial power approach in the area of executive

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[94]*See* Bost, *supra* note 6, at 345 (enumerating the ways in which Enron's outside counsel acquiesced to Enron's misconduct).

[95]*See id.* at 344 (stating Enron's outside counsel accepted auditor's accounting judgments in Enron's financial statements as true).

[96]*See id.* at 346 (noting that Enron's outside counsel was criticized for its limited and superficial investigation).

[97]*See id.* (noting criticism that Enron's outside counsel was nothing more than a "mere interviewer and scrivener").

[98]*See* Bost, *supra* note 6, at 344 ("In accepting the assignment, [Enron's outside counsel] agreed that the scope of its review would be subject to several significant limitations imposed by Enron . . . .").

[99]*See id.* at 346 ("[Enron's outside counsel] convey[ed] a generally reassuring message even though it had institutional knowledge that at least some of the [] transactions were problematic.").

[100]*See* John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 303-04 (2004) (arguing that the failure of gatekeepers—rather than lack of corporate governance or corrupt management—caused sudden surges of financial irregularities in the late 1990s and 2000s).

compensation.[101] While focused specifically on explaining how managers influence the executive pay setting process and undermine the very constraints designed to ensure they perform adequately,[102] the managerial power approach can be applied more broadly to other aspects of a firm's internal governance. In the gatekeeper context, it can be applied to understand power relations in a firm and how a governance practice such as up-the-ladder reporting is actually inhibited by those engaging in misconduct at the upper echelons of the corporate ladder.[103]

Managerial power theory suggests that, while market forces operate to discipline directors who approve excessively high compensation packages or weak incentive plans that reward failure or poor performance,[104] senior executives exert equally strong pressure over corporate directors.[105] Executives' ability to capture the Board may influence both the size and structure of their pay[106] and result in incentive contracts that fail to align interests of shareholders and management.[107] The issue of Board capture is central to understanding how managers influence the systems and structures designed to constrain their self-interested behavior.[108] Bebchuk and Fried indicate the following:

> Directors generally wish to be re-appointed to the board. Average director compensation in the 200 largest U.S. corporations was $152,626 in 2001. In the notorious Enron case, the directors were each paid $380,000 annually. Besides an attractive salary, a directorship is also likely to provide prestige and valuable business and social connections. CEOs play an important role in renominating

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[101] *See generally* Bebchuk et al., *supra* note 26, at 754 (analyzing executive compensation from the perspective of executive influence).

[102] *Id.*; Lucian Arye Bebchuk & Jesse M. Fried, *Executive Compensation as an Agency Problem*, 17 J. ECON. PERSP. 71, 72 (2003).

[103] *See infra* text accompanying notes 132-139.

[104] Bebchuk et al., *supra* note 26, at 756.

[105] *See id.* at 785 (noting ways a CEO may exert power of a board).

[106] Bebchuk & Fried, *supra* note 102, at 74.

[107] Bebchuk et al., *supra* note 26, at 774-75.

[108] *See* Randall S. Thomas & Harwell Wells, *Executive Compensation in the Courts: Board Capture, Optimal Contracting, and Officers' Fiduciary Duties*, MINN. L. REV. 846, 848 (2011) ("Board Capture theory . . . claims that corporations' executives—particularly the [CEO]—dominate their boards of directors and, in essence, set their own pay.").

> directors to the board. Thus, directors usually have an incentive to favor the CEO.[109]

A key aspect of how managerial power distorts optimal compensation arrangements without push-back from investors is the ability of managers to camouflage the extent of their rent extraction.[110] Bebchuk and Fried indicate that "[t]o avoid or minimize the outrage that results from outsiders' recognition of rent extraction, managers have a substantial incentive to obscure and try to legitimize—or, more generally, to camouflage—their extraction of rents."[111]

Managers also engage in clever practices to obscure compensations schemes that substantially exceed those obtained through arm's length bargaining or reward sub-standard performance.[112] While corporations are required to disclose the existence of certain arrangements—for example, retirement compensation—the amount is not reported in the compensation tables and thus is less likely to influence investors' assessment of the firm's governance.[113] As the literature indicates, mangers camouflage their misconduct predominantly through the use of stealth compensation and by influencing compensation consultants.[114]

Stealth compensation makes the total amount of executive compensation received less transparent.[115] Managers use their influence to negotiate higher than normal pension plans, deferred compensation, post-retirement perks, and consulting contracts as a means of increasing their overall pay without triggering push-back from shareholders.[116] Under existing disclosure rules, firms are not required to place an accurate value on post-retirement compensation.[117] Moreover, deferred compensation and post-retirement perks do not impact current earnings let alone show up in the corporation's quarterly disclosure filings.[118] Although now prohibited, executive loans at below-market rates were often used to reduce the actual compensation amounts reported for senior

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[109] Bebchuk & Fried, *supra* note 102, at 73 (citations omitted).

[110] *See id.* at 77-82 (discussing various camouflaging strategies).

[111] *Id.* at 76.

[112] Lucian Arye Bebchuk & Jesse M. Fried, *Stealth Compensation via Retirement Benefits*, 1 BERKELEY BUS. L.J. 291, 293 (2004).

[113] Bebchuk & Fried, *supra* note 102, at 80.

[114] *Id.* at 78-82.

[115] *Id.* at 79.

[116] *Id.*

[117] Bebchuk & Fried, *supra* note 102, at 80.

[118] *Id.*

management.[119] WorldCom is a key example of this phenomenon.[120] Bebchuk and Fried indicate the following:

> WorldCom did not report in its compensation tables any income to CEO Bernard Ebbers from the over $400 million of loans he received from WorldCom at an interest rate of 2.15 percent; it later justified the omission on the grounds that 2.15 percent was the "market rate" at which WorldCom was borrowing under one of its credit facilities. However, 2.15 percent was far below the more than 5 percent rate that Ebbers would have paid at that time in the market to borrow funds. To be sure, the existence and terms of the loans (although not an estimate of the conferred benefits) had to be noted elsewhere in the firm's public filings as a related party transaction. However, this disclosure is much less salient because outsiders interested in executives' compensation commonly focus on the compensation tables.[121]

Compensation consultants supply expertise and contribute useful information on the design of compensation arrangements, in theory creating a layer of insulation between the Board and management.[122] However, Bebchuk and Fried indicate that managers exert their power to use these consultants as an instrument to justify influence over their own pay.[123] Such consultants often do other work for the firm.[124] The CEO usually has discretion to hire these consultants and the power to reduce their assigned work or to terminate their contracts altogether.[125] Thus, independent compensation consultants have a vested interest to approve suboptimal and sometimes excessive executive pay arrangements to

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[119] *Id.* at 80-81.

[120] *Id.* at 80.

[121] Bebchuk & Fried, *supra* note 102, at 80.

[122] *Id.* at 78-79; Bebchuk et al., *supra* note 26, at 772; *see also* Ruth Bender, *Executive Compensation Consultants*, *in* RESEARCH HANDBOOK ON EXECUTIVE PAY 320, 321 (Randall S. Thomas & Jennifer G. Hill eds., 2012) (discussing the expertise possessed by compensation consultants).

[123] Bebchuk et al., *supra* note 26, at 772.

[124] *See* Bender, *supra* note 122, at 324.

[125] *See* Bebchuk et al., *supra* note 26, at 772 (noting managers have the power to control who is hired as a consultant as well as the scope of their report); Bender, *supra* note 122, at 324 ("[A]dvisors might also be removed because the outcome of a scheme was less than the anticipated level of executive reward").

appease the CEO.[126] Pay consultants will often attempt to appease the CEO by providing data and expert opinions that justify higher levels of pay.[127] The Board, in reliance on such consultants, will approve the higher level of pay. [128] The CEO will then use the consultants' report to justify the compensation amount to shareholders.[129] In justifying high pay, management may also focus selectively on accounting returns when market returns are low.[130]

The managerial power approach can be applied to the gatekeeper corporate attorney context to understand better what impedes the willingness of corporate attorneys to dissent and act as whistleblowers.[131] The ways in which managers can camouflage their rent extraction in the executive pay context[132] is illustrative of a broader practice of controlling and manipulating the flow of information to achieve a particular outcome favorable to the CEO but potentially unfavorable to other constituents.[133] While rent extraction in the executive pay context amounts to waste and is damaging to the firm,[134] there is much more at stake with massive accounting frauds such as those of Enron and WorldCom.[135]

Perhaps the most relevant manifestation of managerial power in the context of up-the-ladder reporting is the CEO's influence over outside consultants and in-house professionals, including corporate attorneys.[136] The CEO's power to hire and terminate compensation consultants leaves such consultants beholden to the CEO and compels them to selectively provide information that favors the CEO.[137] This is analogous to the power and influence the CEO can exert over junior and senior in-house

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[126]Bebchuk et al., *supra* note 26, at 772.

[127]*See id.* (finding that compensation consultants cannot recommend clearly excessive compensation packages but will maximize packages to the greatest extent possible to appease managers).

[128]*Id.* at 772-73.

[129]Bender, *supra* note 122, at 323.

[130]*See* Bebchuk et al., *supra* note 26, at 791 (providing that management has flexibility in how it can present economic data when justifying compensation packages).

[131]*See* Coffee, *supra* note 100, at 355 (providing that a conflict of interests exists when an attorney acts as both an advocate and a gatekeeper monitoring proper disclosure).

[132]Bebchuk et al., *supra* note 26, at 789.

[133]*See* Coffee, *supra* note 100, at 318 (clarifying that the broader problem is acquiescence by accountants and consultants to account irregularities and withholding information about the accounts that should be disclosed as part of their gatekeeper duties).

[134]*See id.* at 315.

[135]*See id.* at 316 (stating improper gatekeeper behavior helped cause the overvaluing of Enron, which ultimately caused the bankruptcy and collapse of the corporation).

[136]*See generally* Keogh, *supra* note 86 (discussing up-the-ladder and outside reporting obligations in the U.S. and international contexts).

[137]Bebchuk et al., *supra* note 26, at 790.

corporate attorneys and especially the CLO, when they seek a satisfactory response to evidence of material violations or fraud.[138] The CEO, having direct power over the CLO and indirect power over in-house counsel, can deter whistleblowers not only from reporting material violations in the first instance but also from advancing issues up the ladder when material violations are not initially corrected.[139]

C. *Managerial Power as a Barrier to Dissent: The Case of Enron*

Having outlined the key theoretical tenets of managerial power and how they apply to in-house corporate attorneys, these theoretical assertions can now be explored in the context of a real case. Of particular relevance is the behavior of corporate attorneys in the Enron debacle and the actions and influence of Enron's senior management in the investigation into wrongdoing that ensued.[140]

The case of Enron and particularly the actions of Enron's lawyers illustrate the effects of managerial power with respect to both the manipulation of information flow and to pressures on attorneys to favor the CEO.[141] Enron's primary outside law firm, Vinson & Elkins LLP ("V&E"), played an instrumental role in allowing Enron's senior executives to engage in fraud.[142] Over the five-year period that V&E worked for Enron, it grossed $162 million in fees from Enron alone.[143] In the investigation that ensued, Enron's in-house counsel was also implicated in failing to flag discrepancies in Enron's special purpose entities ("SPE") transactions.[144] Allegedly, Enron was using SPEs to hide corporate losses.[145]

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[138] *See* Keogh, *supra* note 86, at 7 (noting SOX allows an attorney to report directly to the SEC when reporting to the CLO would be futile).

[139] Stephen M. Bainbridge & Christina J. Johnson, *Managerialism, Legal Ethics, and Sarbanes-Oxley Section 307*, 2004 MICH. ST. L. REV. 299, 315 (2004) ("The nature of the market for legal services gives management a set of carrots by which to align the interests of corporate counsel with those of management.").

[140] Bost, *supra* note 6, at 344.

[141] *See id.* at 339-47 (recounting a detailed narrative of attorneys' role in the Enron collapse).

[142] *See id.* at 342-47 (describing V&E's role in the Enron collapse).

[143] *Id.* at 342.

[144] *See* Bost, *supra* note 6, at 346 (stating V&E lawyers allegedly shared their concerns with Enron's in-house counsel).

[145] *Id.* at 340 ("[The SPE] had little business purpose for Enron other than to artificially accelerate income, defer loss or expense, book cash flow from operations on its statement of cash flows, or remove debt from its balance sheet.").

Concerns over the accounting treatment of several transactions were initially raised by Sherron Watkins, a senior Enron executive, in several letters to Enron CEO Kenneth Lay, requesting an independent investigation into the transactions.[146] Watkins specifically requested that V&E not be used, given her concerns over V&E's role in structuring the transactions.[147]

Enron's General Counsel (CLO) responded to Watkins's concerns by requesting V&E's assistance in determining whether Watkins's concerns had any basis; overlooking the conflict of interest arising from V&E's previous involvement with the questionable transactions.[148] Professor Bost indicates the following:

> In accepting the assignment, V&E agreed that the scope of its review would be subject to several significant limitations imposed by Enron: V&E would not second guess the accounting judgments of Andersen reflected in the Enron financial statements; dig down into the transactions in question; attempt to study the particular structure of the transactions; or analyze the adequacy of disclosure of the transactions by rebuilding the disclosure process.[149]

After interviewing several Enron employees, V&E concluded that none of the employees interviewed believed the transactions to be questionable.[150] This conclusion was reached despite a number of significant concerns raised by a V&E attorney that had previous involvement with the transactions.[151] Bost indicates that a number of questions arise over the nature of V&E's investigation:

> As to its nature, why would Enron commission its lawyers to determine and report on the opinions of corporate and

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[146] *Id.* at 343.

[147] *Text of Watkins' Letter to Lay After Departure of Chief Executive*, N.Y. TIMES (Jan. 16, 2002), *archived at* http://perma.cc/VUW3-8LLF.

[148] *See* Letter from Max Hendrick, III, Partner, Vinson & Elkins L.L.P., to James V. Derrick, Jr., Exec. Vice President and Gen. Counsel, Enron Corp. (Oct. 15, 2001) [hereinafter *Vinison & Elkins Report*] (providing a report on V&E's investigation into allegations of accounting improprieties), *archived at* http://perma.cc/47NV-LFCJ.

[149] Bost, *supra* note 6, at 344 (quoting Final Report of Neal Batson, Court-Appointed Examiner, app. C, *In re Enron Corp.*, 2003 WL 25544836 (S.D.N.Y.) (No. 01-16034)) (internal quotations omitted).

[150] *See Vinson & Elkins Report*, *supra* note 148.

[151] Bost, *supra* note 6, at 344.

> accounting insiders, all of whom were immediately and directly available and, in fact, beholden, to corporate management? As to its scope, why would Enron impose limitations on V&E's involvement that would almost necessarily insure that only the views of those insiders would be reported, rather than fresh insights that might result from an independent investigation and review by counsel? What is clear is that V&E's acceptance of the nature and limited scope of the engagement determined its outcome.[152]

In-house attorneys at Enron, working alongside V&E, were also aware of the questionable nature of these transactions.[153] V&E, in fact, shared its concerns with Enron's attorneys, yet neither group chose to take the concerns up the ladder to the CEO or the Board.[154]

This particular aspect of the Enron debacle demonstrates how upper management can influence the parameters of an investigation and manipulate the outcome by defining what the issues are, where to look, and whom to interview.[155] It also demonstrates that not only the outside organizations, but also in-house employees become easily beholden to managerial power and that the latter—despite their gatekeeper function—can be easily deterred from blowing the whistle.[156] In other words, the willingness of in-house corporate attorneys to report wrongdoing up the ladder is significantly impeded by power structures within the company.[157]

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[152] *Id.* at 345.

[153] *Id.* at 346.

[154] *Id.* at 346-47.

[155] *See* Roger C. Cramton, *Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues*, 58 BUS. LAW. 143, 165-67 (2002) (discussing the importance of using independent counsel for internal investigations and emphasizing the inadequacy of the V&E investigation).

[156] *See, e.g.*, Rachel Beller, Note, *Whistleblower Protection Legislation of the East and West: Can It Really Reduce Corporate Fraud and Improve Corporate Governance? A Study of the Successes and Failures of Whistleblower Protection Legislation in the US and China*, 7 N.Y.U. J.L. & BUS. 873, 909 n.118 (2011) (noting that gatekeepers are less likely to blow the whistle on corporate fraud if there is uncertainty as to the legal protection of their employment).

[157] *See* Sung Hui Kim, *The Banality of Fraud: Re-Situating the Inside Counsel as Gatekeeper*, 74 FORDHAM L. REV. 983, 1001, 1003, 1006, 1008-09 (2005) (explaining that because management can produce bigger bonuses, general counsel becomes more pressured to conceal his personal or ethical values that differ from organizational values, other than report

IV. A PROPOSAL FOR A MODIFIED REPORTING STRUCTURE

The authors' proposal for immunizing corporate attorneys who dissent from the effects of managerial power entails a two-prong approach. First, the authors propose to modify the procedure for up-the-ladder reporting to bypass the CEO at every stage in the process.[158] Second, the authors propose that a separate committee of the Board comprised of independent directors be made responsible for hiring the company's CLO and the final approval over terminating the employment of the CLO and any corporate attorneys that work directly for the firm.[159]

A. *Up-the-Ladder Reporting*

The current approach generally requires that junior in-house corporate attorneys report evidence of material violations or fraud up to senior supervising attorneys who must investigate the matter and respond appropriately.[160] If a satisfactory response is not provided in a timely manner or if the senior attorney is unable to provide one, the matter must be reported up to either the CLO or CEO, depending on the power structure within the company.[161] If appropriate action is not taken at this stage, the party who originated the complaint is required to report up to the Board.[162] If all else fails, corporate attorneys are permitted, but not required, to report out to the SEC.[163]

Several windows of opportunity arise for managerial power to affect the outcome of an investigation into potential misconduct[164] and to discourage in-house corporate counsel to report up the ladder.[165] By shaping the outcome of an investigation, upper management can legitimize the alleged misconduct.[166] Even if an in-house corporate

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wrongdoing up the ladder).

[158] *See infra* Part IV.A.

[159] *See infra* Part IV.B.

[160] Keogh, *supra* note 86, at 7.

[161] *Id.*

[162] *Id.*

[163] *Id.*

[164] *See* Bost, *supra* note 6, at 345 (questioning the validity of V&E's investigation because of the nature and scope restrictions set forth by Enron's upper management).

[165] *See* Kim, *supra* note 157, at 1006 (noting that general counsel's hesitation to report up the ladder stems somewhat from the need to please upper management and earn greater bonuses).

[166] *See* Bost, *supra* note 6, at 345-46 (suggesting that the objective of Enron management may have been to use the V&E report to provide an air of respectability to dubious transactions).

attorney is well aware that an investigation has side-stepped the key areas of concern, the fact that management initiated such an investigation makes it increasingly difficult for the attorney to persist in the complaint.[167] Going over the head of the CLO or CEO, after an attorney has voluntarily engaged in an apparently thorough investigation, could increase that attorney's chances of being terminated for over-stepping her authority or attacking senior managers' reputation in bad faith.[168]

The influence of managerial power exists at several points along the corporate ladder and impacts everyone from the CLO down to the most junior in-house counsel.[169] The authors suggest that managerial power's most acute manifestation exists between the CEO and CLO for three reasons. First, the CEO generally has full discretion over selecting, hiring and terminating the CLO.[170] Consequently, CEOs can hire a CLO they know will acquiesce to questionable practices or sanction a CLO who resists their authority.[171] Second, the CEO can influence how the CLO frames an investigation into a complaint by an in-house member of the legal team,[172] thereby diffusing the complaint by legitimizing management's misconduct.[173] Third, the CEO can direct the CLO to resist a complaint of a senior or junior supervising attorney by exerting

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[167] *See* Deborah L. Rhode & Paul D. Paton, *Lawyers, Ethics, and Enron*, 8 STAN. J.L. BUS. & FIN. 9, 18 (2002) (indicating that the failure of Enron executives to investigate the concerns raised by in-house counsel suggests a corporate culture that valued lies over the truth).

[168] *See* Patricia A. Patrick, *Be Prepared Before You Blow the Whistle: Protection Under State Whistle-Blowing Laws*, FRAUD MAG., Sept./Oct. 2010, *archived at* http://perma.cc/2V4S-AJZQ (finding that seventy-four percent of whistleblowers in the author's study were subsequently terminated).

[169] *See* Bainbridge & Johnson, *supra* note 139, at 306-07 (explaining the nature of the legal market gives lawyers strong incentives to overlook management wrongdoing).

[170] *See* Hamermesh, *supra* note 82, at 365-66 (showing that because the CEO hires and establishes the compensation of general counsel, general counsel's ability to serve the interests of the organizational client is hindered where senior managers engage in activity that is detrimental to those interests); *see also* Ben W. Heineman, Jr., *The Rise of the General Counsel*, HARV. BUS. REV. BLOG NETWORK (Sept. 27, 2012, 1:00 PM), *archived at* http://perma.cc/7KN2-E8EY (discussing current trends in the relationships between lawyers and corporations).

[171] *See* Stephen M. Bainbridge, *The Tournament at the Intersection of Business and Legal Ethics*, 1 U. ST. THOMAS L.J. 909, 920 (2004) (explaining that general counsel has a strong incentive to stay on the good side of senior management, for his tenure depends mainly on his relationship with the CEO).

[172] *See* Bost, supra note 6, at 345 (questioning the validity of V&E's investigation because of the nature and scope of restrictions set forth by Enron's upper management).

[173] *See id.* at 345-46 (proposing that Enron management sought to use the V&E report to convey a soothing message to the board audit committee).

pressure on that staff member.[174] Accordingly, in-house attorneys would be less willing to pursue a complaint even when they know of ongoing misconduct.[175]

B. *Board Insulation of In-House Corporate Attorneys*

The first prong of the proposed normative model entails modifying the procedure for reporting up the ladder to bypass the CEO and requiring the Board to hold an independent investigation with minimal involvement from the CEO.[176] This investigation could be performed by a legal committee comprised of independent directors, assembled by the entire plenum of the Board or by the entire Board itself with the CEO abstaining from voting if she sits on the Board.[177]

The legal committee or the Board can enlist the help of independent outside counsel if required to alleviate the additional burden on directors themselves.[178] Moreover, the CEO should be kept at arm's length as much as possible during the investigation.[179] Additionally, the Board should seek necessary directives from the firm's legal department and the department(s) where the problem is thought to have originated.[180] The CEO's engagement, if required, should be limited, to the procurement of documents in his or her possession where possible.[181] Requests for explanations from the CEO should be avoided until any and

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[174] *But see* Hamermesh, *supra* note 82, at 383 (positing that "a direct and strong relationship" between a CEO and general counsel may increase corporate compliance).

[175] *Id.* at 371-79.

[176] *See id.* at 366 ("To varying degrees, commentators have lamented general counsel's perceived lack of ability to promote the best interests of the organization, due to lack of independence from senior management.").

[177] *See id.* at 371-79 (critiquing this view).

[178] *See* Hamermesh, *supra* note 82, at 373-74 (discussing pros and cons of using general counsel as a gatekeeper).

[179] *But see id.* at 378-79 ("The more that inside counsel . . . [is] institutionally established as gatekeepers at arm's length from . . . CEOs, the less likely it is that such counsel will obtain information and be heeded with respect to advice on sensitive issues of corporate compliance and responsible behavior."); *see also* Z. Jill Barclift, *Corporate Governance and CEO Dominance*, 50 WASHBURN L.J. 611, 617-20 (2011) (outlining why it may be difficult to remove CEOs from corporate governance).

[180] *See* S. Rep. No. 107-70, at 46-47 (2002) (suggesting that the Enron collapse could have been avoided or lessened if the Board looked into Enron's accounting).

[181] *See* Donald C. Klawiter, *New World Order: The Risks and Consequences to Corporate Executives in Antirust Investigations in the Post-ADM, Post-Enron World*, 31 INT'L BUS. LAW. 53, 57 (2003) (noting that even after an investigation of corporate fraud has been launched, CEOs attempt to influence their subordinates by ordering them to testify in a certain manner).

all investigations into the complaint are completed and a preliminary conclusion is reached.[182]

Such an approach is aimed at preventing the CEO from steering the investigation and influencing investigators' perceptions of their findings during the process.[183] It is crucial, in this context, to limit upper management's ability to lead and frame an investigation into its own potential wrongdoing and to use parties such as in-house counsel, the CLO, and outside firms to manipulate information flow and to compartmentalize various parts of an investigation.[184] Enron provides a glaring example of how the CLO Jim Derrick ("Derrick"), likely under pressure from the CEO Kenneth Lay ("Lay"), enlisted an outside firm to conduct a narrowly defined investigation that from the outset was intended to block information sharing between the legal and accounting departments.[185]

The second prong of the normative model entails delegating the responsibility of hiring or terminating the CLO and any in-house corporate attorneys to a separate committee of the Board comprised of independent directors.[186] Evidence from Enron demonstrates how the CLO limited the scope of the investigation to create a particular outcome.[187] While it is not entirely clear whose orders he followed, it can be reasonably inferred from the facts that Enron's CLO was beholden to managerial influence.[188] For instance, Watkins's complaint was made directly to Lay, who then delegated the matter to the CLO for investigation.[189] Being upper management himself, Derrick likely had an

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[182] *See id.* ("[T]he executive . . . is likely to find himself removed from even the most basic discussions of the investigation with,corporate and outside counsel").

[183] *See* Barclift, *supra* note 179, at 618 (discussing how the CEO's control over the flow of information may orchestrate blockages).

[184] *See, e.g.*, SPECIAL INVESTIGATIVE COMM. OF THE BD. OF DIRS. OF ENRON CORP., REPORT OF INVESTIGATION 176 (2002), *archived at* http://perma.cc/9RCQ-CXVJ (concluding that the results of the V&E's review of Enron's finances were "largely predetermined" because Enron and V&E agreed that a detailed examination of the relevant transactions and discussions with Enron's accounting advisors would be outside the scope of the investigation).

[185] *See id.* at 173 (documenting the major communications between Lay and Derrick and suggesting that they both decided to limit V&E's review).

[186] *See* Hamermesh, *supra* note 82, at 381 (describing the benefits of involving independent directors in selection of counsel).

[187] *See* SPECIAL INVESTIGATIVE COMM. OF THE BD. OF DIRS. OF ENRON CORP., *supra* note 184, at 173 (documenting Derrick's compliance).

[188] *See* Barclift, *supra* note 179, at 618 ("[I]n the wake of the Enron scandal, studies revealed that management either supported the CEO in fostering a culture of dishonesty or feared reprisal for disagreeing.").

[189] Bost, *supra* note 6, at 343.

intimate working relationship with Lay, who wielded enormous power over the employment of his inner circle.[190] For this reason, Derrick likely felt compelled to favor and protect his colleague's economic interests and reputation.[191]

This proposal for a modified reporting model seeks to remove the ability of the CEO to influence the hiring and termination of a firm's CLO as well as members of the in-house legal team.[192] While the CLO, out of necessity, will continue to have an intimate working relationship with the CEO, there will be less pressure to favor and defend questionable conduct.[193] Most importantly, if the CLO's ability to terminate members of the legal team who report up the ladder is curtailed, junior and senior employees will have less of an incentive to support and reinforce questionable decisions out of fear of losing their jobs.[194] While the CLO, for practical reasons, must retain discretion over disciplining and possibly terminating his employees, the authors suggest that a legal committee made up of independent directors of the Board have final authority over termination of any corporate attorneys who have dissented to questionable corporate conduct, even if their concerns prove to be wrong.[195]

To avoid foreclosing on both the CLO and CEO's discretion to determine how in-house legal counsel is utilized, hired, managed and disciplined, the authors suggest narrowing the Board's authority to final approval over terminations of the in-house legal team.[196] For instance, a disciplinary action, including termination of a junior or senior in-house counsel, should still be initiated by the CLO.[197] Likewise, any change to

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[190] *See* Barclift, *supra* note 179, at 618 ("Few executives took any action against the ill-conceived ideas of Enron's flamboyant leaders.").

[191] *Id.* at 618-19.

[192] *See* Susanna M. Kim, *Dual Identities and Dueling Obligations: Preserving Independence in Corporate Representation*, 68 TENN. L. REV. 179, 204 (2001) (explaining that in-house counsel face stronger pressure to conform to the wishes and objectives of managers who have authority to fire them).

[193] *See id.* at 206.

[194] *But see id.* at 207 ("Inside lawyers are often reminded that they are part of the corporate team and rewarded when they act as 'team players.'").

[195] *See* Hamermesh, *supra* note 82, at 380 (suggesting that the Board can encourage independence by articulating that it expects counsel to exercise independent judgment).

[196] *Cf.* E. NORMAN VEASEY & CHRISTINE T. DI GUGLIELMO, INDISPENSABLE COUNSEL: THE CHIEF LEGAL OFFICER IN THE NEW REALITY 56 (2012) (explaining that a Board should generally be consulted on counsel's employment and termination even when a conflict among executives is present).

[197] *See id.* at 40-41 (noting the general counsel should devote "substantial time" to managing employees and monitoring outside legal services).

the employment of the CLO can and should be initiated by the CEO.[198] However, the Board, or a duly appointed committee that excludes the CEO, would bear a procedural duty to ascertain whether the in-house attorney whose termination is being sought by management has initiated or is about to initiate a complaint against a superior for suspected material violations or even fraud.[199] In fact, the in-house attorney in question should be given an opportunity to raise this issue directly to a committee and demonstrate the basis for the initial concerns of suspected material violations of law at the company.[200]

Additionally, it is important to enable the Board or committee to scrutinize the hiring of corporate attorneys, namely the CLO.[201] This scrutiny lessens the extent to which a prospective CLO would acquiesce *ex ante* to the CEO's demands as a condition to getting hired.[202] While the CEO could recommend a CLO from his network, the Board would have an opportunity to scrutinize the individual and have the final say over her hiring.[203] The Board or its committee could make counter recommendations if deemed appropriate.[204] This addresses the problem of managerial power analogous to the influence exerted by CEOs over compensation consultants in public companies.[205] As described by Bebchuk and Fried, even so-called independent compensation consultants become easily beholden to the CEO who controls how much work they are given by the firm.[206] The influence of managerial power over compensation consultants helps to justify higher levels of pay.[207] Likewise, consultants who develop a reputation among top management

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[198] E. Norman Veasey & Christine T. Di Guglielmo, *The Tensions, Stresses, and Professional Responsibilities of the Lawyer for the Corporation*, 62 BUS. LAW. 1, 10 (2006).

[199] Pam Jenoff, *Going Native: Incentive, Identity, and the Inherent Ethical Problem of In-House Counsel*, 114 W. VA. L. REV. 725, 737 (2012).

[200] *See* Bainbridge & Johnson, *supra* note 139, at 318 (positing that an in-house attorney confronting a CLO or CEO about their misconduct may allow the CLO or CEO to continue their misconduct).

[201] *See* Veasey & Di Guglielmo, *supra* note 198, at 13 ("[T]he board of directors should have approval responsibility for selecting, retaining, and compensating the general counsel.").

[202] *See id.* at 12-13 (discussing how the Board's involvement may lessen the general counsel's financial dependence).

[203] *Id.* at 13.

[204] *See id.*

[205] *See* Bebchuk & Fried, *supra* note 102, at 78-79 (describing the strong incentives the compensation consultants have "to use their discretion to benefit the CEO").

[206] *Id.* at 79.

[207] *See* Bender, *supra* note 122, at 326 tbl. 16.1 ("[C]lients have some power over the consultancy firm, as the impact on a consultancy of losing clients could be a loss of reputation, potentially damaging future income.").

at public companies for scrutinizing the CEO's pay package or for being unusually diligent will jeopardize their prospects of obtaining assignments from other companies.[208]

The authors suggest shifting some power into the Board's hands to scrutinize the hiring of senior legal staff by making two changes.[209] One change is to give the Board or its committee the final approval over hiring the CLO. This entails the ability to reject the CEO's recommendations and to propose an alternate CLO if necessary.[210] The other change is to create a procedural duty for the Board to inquire into previous dealings between the CEO and prospective CLO.[211] This entails an assessment of several factors that could indicate a conflict of interest between the CEO's prerogative to hire a CLO that easily acquiesces to managerial power on the one hand,[212] and his duty to act in the bests interests of the corporation by hiring a CLO who can react appropriately in the face of material non-compliance or even fraud on the other hand.[213] These factors might include the following:

(a) the scope and magnitude of the transactions conducted between the prospective CLO and the corporation;[214]
(b) the extent to which the CEO personally, while acting on behalf of the corporation, requested or authorized such transactions;[215]
(c) any implication of the prospective CLO in a previous material non-compliance, misstatements, or questionable transactions of any type;[216]

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[208] *See id.* at 324 n.1 (suggesting that consultants that produce results deviating from the corporate norm are not rewarded).

[209] *See infra* text accompanying notes 210-218.

[210] Hamermesh, *supra* note 82, at 383-84.

[211] *See* Veasey & Di Guglielmo, *supra* note 198, at 13-15 (exploring the "loyalty" employment relationship between the general counsel and senior management).

[212] *See id.* at 14 (forewarning that loyalty and financial incentives may make general counsel more susceptible to management pressuring).

[213] VEASEY & DI GUGLIELMO, *supra* note 196, at 47-48 (stressing the importance of hiring the CLO that is not afraid to contradict the CEO).

[214] *See* Veasey & Di Guglielmo, *supra* note 198, at 12 (pointing out that paying the general counsel with stock options may raise questions about his independence).

[215] *See* Deborah L. Rhode, *Moral Counseling*, 75 FORDHAM L. REV. 1317, 1320 (2006) ("Lawyers have been implicated in almost all of the major health, safety, and financial scandals of recent decades.").

[216] Deborah A. DeMott, *The Stages of Scandal and the Roles of General Counsel*, 2012 WIS. L. REV. 463, 474 (2012) (stressing the importance of reputation for general counsel).

(d) the general reputation of the prospective CLO for making decisions which favor management;[217] and

(e) any previous involvement of the CLO in serving on a compensation committee or as a compensation consultant, especially for the CEO who is seeking to hire him.[218]

To summarize, the proposed normative approach is two-fold. The authors propose to modify the procedure for up-the-ladder reporting by requiring in-house attorneys to bypass the CEO[219] and by establishing a separate committee of independent directors responsible for hiring the company's CLO and the final approval over terminating the employment of the CLO and any corporate attorneys that work directly for the firm.[220]

C. *Potential Problems*

An obvious issue arises from this proposal that merits an explanation: If corporate Boards are beholden to upper management, reporting directly to the Board might not be an antidote to managerial power. The most obvious answer is that managerial influence over in-house counsel and the reporting process is more direct and stronger than managerial influence over the Board for the same matter.[221] If the CEO has direct power to hire and fire corporate counsel, eliminate legal work by hiring an outside firm, or the ability to define and shape an investigation and its outcome, then corporate counsel could be significantly deterred from blowing the whistle at any level.[222] The Board, on the other hand, is not in a position where it answers to the CEO directly, despite managerial influence at play.[223] Unlike the executive pay context where management bargains directly with the Board for pay,[224] during an investigation into non-compliance or fraud,

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[217] *Cf.* Bender, *supra* note 122, at 324 (indicating that corporations may hire consultants based on personal recommendations).

[218] *Cf. id.* at 323 (stating the Dodd-Frank Wall Street Reform and Consumer Protection Act requires assessment of business and personal relationship between a consultant and the corporation, its owners, and constituents when evaluating the consultant's independence).

[219] *See supra* Part IV.B.

[220] *See supra* Part IV.B.

[221] *See* Hamermesh, *supra* note 82, at 383-84 ("Establishing a direct relationship between general counsel and independent directors is . . . likely to enhance general counsel's stature and ability to exercise and promote independent judgment.").

[222] *See supra* Part III.A-B.

[223] *See supra* Part III.A.

[224] *See* Bebchuk & Fried, *supra* note 102, at 73 ("Optimal compensation

the CEO, in theory, is not required to interact with the Board until later in the process, once an independent investigation is commenced.[225] Thus, any form of managerial involvement in the initial stages of the process would be harder to justify given the illegitimacy of such involvement.[226]

Despite any influence a CEO may have on particular board members, the ability of in-house counsel to bypass the CEO and report directly to the Board, when material violations or fraud is suspected, is a way of lessening managerial influence.[227] When a separate committee of the Board—comprised of independent directors—is tasked with conducting an investigation, there is an added layer of insulation between management and the committee members.[228] While certain members of this committee might still feel beholden to the CEO, there would likely be a sufficient blend of captured versus non-captured members to ensure a fair and moderately thorough investigation of any alleged wrongdoing or fraud.[229] This insulation could be further enhanced if the Board's investigatory committee delegates part of the investigation to an outside independent firm not implicated in the transactions they are investigating, like V&E was in the Enron debacle.[230]

The other potential problem is the practical limitations of Board oversight and the unwillingness of Board members to take on additional responsibilities.[231] Conducting a thorough investigation into misconduct is an arduous task that most Boards are ill-equipped to carry out given time limitations, lack of expertise, and the level of commitment that most Board members have to governing the firm.[232] Many directors who sit on

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contracts [may] result . . . from effective arm's length bargaining between the board and the executives . . . .").

[225] *See supra* Part IV.B.

[226] *See supra* text accompanying notes 164-175.

[227] *See supra* Part IV.B.

[228] *See* Steven T. Petra, *Do Outside Independent Directors Strengthen Corporate Boards?*, 5 CORP. GOVERNANCE 55, 60 (2005) (noting the SEC believes boards, rather than management, should retain outside counsel for special investigations).

[229] *Contra id.* at 62 ("Public skepticism of the ability and/or willingness of outside independent directors to monitor and control the actions of top management is well founded.").

[230] *See id.* at 60 (noting the SEC does not recommend engaging the corporation's usual outside counsel as the independent special counsel).

[231] Martin Lipton & Jay W. Lorsch, *A Modest Proposal for Improved Corporate Governance*, 48 BUS. LAW. 59, 65-66 (1992) (discussing the reasons independent directors fail to assert leadership in boardrooms); Pornsit Jiraporn et al., *Too Busy to Show Up? An Analysis of Directors' Absences*, 49 Q. REV. ECON. & FIN. 1159, 1170 (2009) (noting that busier directors are more prone to absenteeism); *see also* Nikos Vafeas, *Board Meeting Frequency and Firm Performance*, 53 J. FIN. ECON. 113, 114, 140 (1999) (a study showing a direct relationship between board meeting frequency and firm performance).

[232] *See* Lipton & Lorsch, *supra* note 231, at 64-65 (suggesting that independent directors' lack of time and expertise hinders meaningful exchanges with corporate insiders).

Boards of public companies typically sit on more than one Board or have full-time careers and treat directorships as part-time jobs.[233] In 2011, the median total compensation for directors of the largest U.S. companies was $190,000.[234] Directors are generally required to attend a series of meetings throughout the year and perform other governance related tasks.[235] While this amount seems generous, it pales in comparison to what many directors can earn either as CEOs, investment bankers, or high-ranking corporate lawyers.[236]

Professors Theodor Baums and Kenneth Scott identify three roles that Boards have traditionally played in operating a firm.[237] They are as follows:

(1) An advisory role to top management in which the Board attempts to oversee management and ensure its compliance with the law, but otherwise defers to management's judgement in how it balances interests in conjunction with a valid corporate purpose;[238]

(2) A shareholder-agent role in which the Board acts on the shareholders' behalf, replacing under performing managers and implementing contractual measures that ensure maximum performance and shareholder returns;[239] and

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[233] *Id.* at 64.

[234] *See* Matteo Tonello, *The 2011 U.S. Director Compensation and Board Practices Report*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Nov. 11, 2011, 9:05 AM) ("Median total [director] compensation ranges from $46,843 in the smallest companies to $190,000 in the largest companies."), *archived at* http://perma.cc/AXL5-E6QS.

[235] *See* Lipton & Lorsch, *supra* note 231, at 64-67 (explaining that typical boards meet less than eight times annually and that independent directors are tasked with analyzing the company's affairs and monitoring the management).

[236] GREG RUEL, GMI RATINGS, 2013 CEO PAY SURVEY 4 (2013) (reporting that median total compensation for CEOs of S&P 500 companies in 2012 was $9.8 million), *archived at* http://perma.cc/8JF4-T4LQ; James B. Stewart, *The Dawn of Lower Pay on Wall St.*, N.Y. TIMES (Jan. 20, 2012) (finding managing director pay at two large financial institutions rose to $400,000 and $600,000 respectively), *archived at* http://perma.cc/VJ68-CWHT; Abby Rogers, *15 Mind-Blowing Salaries Pulled in by Corporate America's Top Lawyers*, BUS. INSIDER (Jul. 1, 2012, 12:00 PM) (reporting that the highest salary for general counsel was $9,840,184 in 2011), *archived at* http://perma.cc/6PX3-5EAG.

[237] Theodor Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, 53 AM. J. COMP. L. 31, 53-54 (2005).

[238] *Id.* at 53.

[239] *Id.* at 53-54.

(3) A stakeholder role in which the Board consistently reconciles the interests of those parties that are regularly impacted by the firm's actions.[240]

Investigating misconduct at arm's length and independently from management is consistent with the above roles that Boards have played and does not require a drastic reconceptualization of directors' duties.[241] Whether the Board performs an oversight function,[242] acts in the interests of shareholders,[243] or plays a balancing role,[244] it ensures that the corporation's viability is not jeopardized by managerial misconduct.[245]

Delegating a proposed duty to investigate and to scrutinize the hiring and termination of the CLO to an independent committee of the Board or to an outside professional body could be a feasible option for implementing our proposal.[246] Currently, only independent directors may serve on certain public companies' committees.[247] Audit and legal compliance committees have recently been added to the list.[248] These committees are arguably equipped to investigate both potential misconduct and to scrutinize the hiring and termination of key legal staff members.[249] The potential that independent legal compliance committees could play in fulfilling these roles needs to be further assessed.[250]

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[240] *Id.* at 54.

[241] *See* Baums & Scott, *supra* note 237, at 53.

[242] *Id.* ("Only in a crisis or unusual circumstances would the board try to override, or even replace, the CEO.").

[243] *Id.* at 53-54 ("This perspective would require the board . . . to monitor management performance in a more demanding way.").

[244] *Id.* at 54 (adding that it is "unclear" to what extent shareholders' interests should predominate in this balance).

[245] *But see* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1490-95 (2007) (discussing factors that affect Board independence).

[246] *See supra* Part IV.B.

[247] *See* Gordon, *supra* note 245, at 1490-95 (enumerating independent committees).

[248] 15 U.S.C. § 78j-1(m)(3)(A) (requiring that all members of an audit committee be independent); Jill E. Fisch & Caroline M. Gentile, *The Qualified Legal Compliance Committee: Using the Attorney Conduct Rules to Restructure the Board of Directors*, 53 DUKE L.J. 517, 532-34 (2003) (describing the requirements for the qualified legal compliance committee).

[249] *See* Fisch & Gentile, *supra* note 248, at 533 (noting the authority of a qualified legal compliance committee must include both investigation of reported misconduct and the ability to recommend an "appropriate response").

[250] *Cf. id.* at 553-66 (providing an early assessment of the ability of audit and legal compliance committees to improve corporate governance).

V. CONCLUSION

This article has noted the significant dilemma that in-house corporate attorneys face in either reporting up the ladder or reporting out instances of corporate wrongdoing or fraud.[251] The current debate centers on how corporate attorneys should reconcile their duties of confidentiality to their clients against their obligations under Section 307's reporting out provision.[252] However, this article examines a new line of inquiry by considering how Section 307's reporting up provision may subject in-house corporate attorneys that attempt to report corporate wrongdoing or fraud up the ladder to retribution or dismissal by the corporation's senior management.[253] This article moves the discussion beyond the current debate on Section 307 by addressing how managerial power impedes in-house corporate attorneys from reporting up the ladder improper or fraudulent corporate transactions,[254] and by proposing a modified reporting structure designed to immunize in-house corporate attorneys from the risks associated with whistle-blowing pursuant to Section 307's reporting up the ladder provision.[255]

This article proposes a two-pronged approach to immunize corporate attorneys who report suspected fraudulent or otherwise illegal acts within their organizations.[256] First, this article proposes to modify the procedure for up-the-ladder reporting by requiring in-house corporate attorneys to report wrongdoing directly to the Board and bypass the CEO.[257] Second, it proposes that a separate Board committee, comprised of independent directors, be responsible for hiring the company's CLO[258] as well as terminating the CLO and any corporate attorneys that work directly for that company.[259]

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[251] *See supra* Part I.
[252] *See supra* Part II.
[253] *See supra* Part II.C.
[254] *See supra* Part III.A.
[255] *See supra* Part III.B.
[256] *See supra* Part IV.
[257] *See supra* Part IV.A.
[258] *See supra* Part IV.A.
[259] *See supra* Part IV.B.