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Agency, Authority, and Compliance

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Thanks to Todd Haugh, Ethan Leib, Bob Mascola, Dan Sokol, Rory Van Loo, and an anonymous reviewer for thoughtful comments on earlier drafts of this chapter, and thanks to Kevin Sette for helpful research assistance. The viewpoints expressed and any errors herein are mine alone.

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Abstract

Compliance can and often does serve as a conduit through which regulators and enforcement authorities enlarge their authority beyond statutory bounds. The potential to do so is a function of the symbiotic relationship between compliance officers and regulatory authorities. Compliance officers owe their professional existence and their organizational authority to the interventions of regulators and enforcement agents. This creates a unique incentive structure and renders compliance officers especially receptive to regulators' extra-legal pronouncements. As a result, the separation of compliance from legal and the elevation of the compliance function as the co-equal of the legal department, a structure often insisted upon by regulators and enforcement authorities, effectively enlarges the compliance conduit through which the government may abuse the rule of law. Rather than separating compliance from legal, compliance should be subordinated to legal so that an officer accountable exclusively to the best interests of the firm is charged with interpreting the law and advising the firm on what the law requires. Only after this determination has been made should compliance officers be charged with the task of executing on these decisions. A necessary condition to realigning organizational responsibilities in this way, however, is for the government to stop insisting on the alternative. More broadly, the government should not involve itself in the organizational details of compliance, but rather should limit itself to making and enforcing the law.

Keywords: compliance, corporate governance, enforcement, regulation, ethics, legal, general counsel, chief compliance officer, rule of law, ethics officer, administrative procedure act, prosecutor

JEL Classifications: K22, K23, K14

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Agency, Authority, and Compliance

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CAMBRIDGE HANDBOOK OF COMPLIANCE, Sokol & van Rooij, eds. (forthcoming 2020)

Abstract

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Introduction

Law, ethics, and compliance are conceptually distinct. Law is what you must do—the rules and regulations originating from the sovereign, transgression of which may lead to deprivation of property or, in some cases, liberty. Ethics is what you should do. Ethical norms originate from somewhere other than the sovereign, and when transgressed, may generate negative publicity and lead to adverse consequences in capital, product or labor markets. Finally, compliance is what a person does in order to ensure that she is doing what she must or should. Or, more concisely: law and ethics are different ways of answering *what* to do, while compliance answers *how* to do it.

Legal and ethical requirements may be vague or ambiguous. This is true both internally—what law or ethics requires may not be clear—and in relation to each other—an action may be legal but not ethical or vice versa. The question thus becomes one of authority. Who decides what law or ethics requires of the organization? And who decides what the organization ought to do in cases of conflict?

The answer, in many business organizations, is compliance. In addition to deciding *how* to execute the dictates of law or ethics, the compliance function increasingly also decides *what* law or ethics requires of the organization. This result is a natural consequence of the organization of compliance within firms. In the last two decades and especially since the global financial crisis of 2008, the importance of compliance departments has expanded vastly, largely due to the pressure of prosecutors and regulators. Compliance has largely subsumed ethics and, thanks again to regulatory pressure, established itself as independent from and equal in authority to the legal department in many firms. At such firms, the Chief Compliance Officer (or "CCO"), need not subordinate her judgment to the source of legal authority within the firm, the General Counsel (or "GC"), but rather can decide for herself whether conduct is legal or ethical. The CCO makes policy determinations relating to law and ethics, then designs procedures to bring her policies into effect.

This reallocation of authority would not be worth serious scholarly attention were it purely internal to the firm. Management is ordinarily trusted to organize the internal departments of the firm in the same way that it is entrusted with deciding what to make and sell, whether to expand or contract, and whom to hire or fire. But in fact, the organization of compliance does not come entirely from management. Compliance owes its existence and much of its authority to exogenous sources—prosecutors and regulators. As a result of its exogenous origins, compliance is not wholly accountable to intra-firm authority structures. This creates incentives for compliance officers to consider regulatory interests as co-equal to the interests of the firm, making them receptive to regulatory pronouncements regardless of whether of those pronouncements meet the formal requirements of law. This in turn creates an opportunity for regulators to extend their *de jure* authority by exercising it through their *de facto* agents inside

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the firm. This result is inconsistent with fundamental rule of law values. No statute confers upon regulators the authority to pronounce law in this way. Yet regulators and enforcers have imposed an organizational structure upon firms that creates this authority for themselves.

This chapter analyzes agency and authority in the internal organization of compliance, ethics, and law departments. It describes how the allocation of authority to each of those roles has shifted in recent decades, due in large part to regulatory interventions. It also describes the effect of that shift. Far from the trivia of who reports to whom, the result is an organizational structure that facilitates governmental interventions in private firms and the taking of greater regulatory authority than has in fact been legally conferred upon regulators.

Compliance should be subordinated to legal rather than separated from it. Making compliance report to legal means putting the question of how after the question of whether or why. Furthermore, because the GC's authority flows from shareholders, not exogenous enforcement authorities, the GC is less likely than the CCO to confound the distinction between law—what the firm must do—and guidance—what regulators might prefer the firm to do. As long as this distinction is clear and clearly presented to agents capable of deciding what is best for the firm, larger rule of law concerns are mitigated. Nevertheless, in order for these authority and accountability structures to function as they should, the government, as the source of law, must limit itself to telling firms what they must do rather than also telling them how they must do it. Government, in other words, should make the rules and sanction firms for falling short. But it should not impose compliance structures on firms or deputize intra-firm agents to carry out their enforcement agenda.

From this introduction, this chapter proceeds as follows: First, it describes the rise of corporate ethics and documents how ethics functions have been effectively subsumed by compliance. Second, it probes the origins of the modern compliance function, demonstrating the ways in which compliance has evolved in direct response to governmental interventions, typically through prosecutions or regulatory enforcement actions. Third, it shows how the exogenous origins of compliance and continued governmental interventions into the structure of compliance corrupt intra-firm lines of accountability and transform compliance officers into quasi-governmental agents with incentives to align firm conduct with regulatory pronouncements. Fourth, it demonstrates how this structure leads to regulatory rule-making that exceeds the limits of the law and brings the modern compliance function squarely into conflict with rule of law values. Fifth and finally, it attempts to show the way out, by subordinating compliance to legal and limiting government to making and enforcing the law, not to meddling with the internal organization of compliance.

1. Compliance Subsumes Ethics

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The idea of ethical business conduct is an old one, but corporate codes of ethics are more recent. Companies began adopting codes of ethics in the 1970s to commit themselves publicly to fair business practices and evolving norms against commercial bribery (de George 2015). These codes received a significant boost following the Enron and WorldCom scandals in 2001, after which the Sarbanes-Oxley Act required public companies to either adopt an ethics code or explain why they had not (15 U.S.C. § 7264). The New York Stock Exchange now also requires listed companies to adopt a code of ethics (NYSE Listed Companies Manual § 303A.10). As a result, codes of ethics have become common among large corporations.

The results of research into the effect of ethics codes on corporate behavior, however, are not encouraging. Studies comparing firms that have adopted codes of ethics to firms that have not are mixed (Kaptein & Schwartz 2008). Some find that the adoption of a code of ethics has a significant positive effect; others find no significant effect; others find results somewhere in the middle. Other work challenges the methodology of these studies, which often rely on survey data, arguing that methodological weaknesses preclude serious reliance on their findings (Kraweic 2003). As a result, the effect of ethics codes on corporate conduct remains unclear.

Nevertheless, studies do find that when an ethical code is combined with additional monitoring or enforcement mechanisms, the effect on firm behavior is more pronounced (Nitsch et al. 2005; Rottig et al. 2001). The difference, it seems, is not the code itself, but rather the systems the corporation has adopted for implementing it. This should come as no surprise. Codes are inert. They are only brought to life by mechanisms for implementing them. But the animating principle is what we have defined as compliance. Compliance is "the *processes* by which an organization seeks to ensure that employees and other constituents conform to applicable norms" (Miller 2014).

Compliance has largely subsumed ethics. Many organizations combine ethics and compliance into a single department with a single head. Sometimes this person is given the title of Chief Ethics and Compliance Officer, but frequently it is just the Chief Compliance Officer (PricewaterhouseCoopers 2014). On the one hand, this is natural. Once the conversation moves from principles to implementation, the subject has changed from ethics to compliance. And insofar as compliance designs and implements policies and procedures, it is natural to allocate implementation of the corporate ethics code—a kind of policy—to compliance. So putting compliance together with ethics does not necessarily imply that compliance has swallowed ethics. It could be the other way around: perhaps ethics has swallowed or expanded into compliance.

The development of compliance, however, suggests that this is not the case. Instead, the explosive growth of compliance at American corporations, driven principally by prosecutions and regulatory interventions, has made ethics the junior partner in the relationship. This can be

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seen most clearly through a consideration of the origins of the compliance function, the subject of the next part.

2. The Exogenous Origins of Compliance

On June 7, 2018, the U.S. Department of Commerce announced the terms of a settlement with the Chinese telecommunications firm ZTE, under which the firm agreed, in order to rectify past misconduct and ensure compliance going forward, to hire a team of "compliance coordinators selected by and answerable to [the Department of Commerce] for a period of 10 years." (Department of Commerce Press Release). In other words, the settlement required the company to hire compliance officers to implement an enforcement agenda and, in doing so, report directly to the government. Although the example is a striking one—most compliance officers are not selected by or made to report directly to the government—something like it happens all the time.

The modern compliance function is a direct outgrowth of governmental interventions. Corporate compliance programs are expressly designed to meet governmental standards, and the authority of corporate compliance officers derives in large part from the government—as a kind of outsourced enforcement agent. As with ZTE's settlement with the Commerce Department, compliance reforms are often extracted as settlement conditions by the Justice Department. As a result, although ZTE presents an extreme case, it is a difference of degree, not kind. Compliance officers owe their positions and their authority to governmental interventions in the firm.

The government's first major foray into corporate compliance came during the drafting of the Organizational Sentencing Guidelines (Arlen 1994). In response to early drafts of the Guidelines that promised to vastly increase penalties for corporate criminal conduct, a number of leading corporations lobbied the Sentencing Commission to include compliance as a mitigating factor (Clark 1994). For example, the Martin Marietta Corporation implored the commission to "find a balance between imposing sentences on corporations for their wrongdoing and at the same time trying to incentivize corporations to develop meaningful compliance programs." Likewise, General Electric encouraged the Commission to adopt a system where there would be "no penalty fine for a corporation that has developed and implemented stringent policies and training, and yet has a low-level employee go astray." The Business Roundtable joined the lobbying effort, arguing that "compliance programs are the best way to encourage compliance with the law" and that corporate crime would best be reduced "by trying to encourage, enhance, build, expand not only the presence of compliance programs in corporations but also the effectiveness and vigor with which they are administered and enforced inside the corporation." The result was the inclusion of an "effective compliance program" as a factor mitigating the

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punishment of corporate crime. Ultimately, the Guidelines articulated the features of an effective compliance program, including the now famous "seven factors."[1]

Of course, the Guidelines alone force compliance on no firm. They merely specify the sentences that judges may impose when corporations are convicted. Such convictions are rare (Henning 2007). But bargains are struck in the shadow of the law (Cooter et al. 1982). The real impact of the Guidelines and the compliance structures they encourage thus lies in the way they guide the parties toward settlement.

Compliance has become part of the settlement process in two ways. First, the existence and adequacy of a corporation's compliance program factor into the prosecutor's charging discretion according to a set of factors enshrined in the U.S. Attorney's Manual (§9-28.800.B). Second, prosecutors frequently make compliance enhancements a condition of settlement (Garrett 2014; Kaal & Lacine 2014). Compliance reforms extracted at settlement frequently focus on improvements to policies and procedures, training, and employee monitoring. These may include the adoption of a formal compliance charter or code, revisions to existing compliance policies, and improvements in communications or training. Settlements often call for the hiring of additional employees in compliance, and occasionally also provide for a new chief compliance officer or the establishment of a board-level committee or reporting structure. These are extensive internal reforms, far beyond simple commands to stop disobeying the law or fines for past violations (Barkow 2011). Moreover, the ability to extract these reforms enables regulators to "advance the agency's policy goals even if the original behavior was not clearly illegal—such as when a monitor believes a company's internal process for reviewing legal complaints is likely to miss future violations" (Van Loo 2019).

Compliance reforms extracted by prosecutors and regulators have an impact not only on the counterparty to the settlement, but often across an entire industry. In an accretive process not unlike the common law, the actions brought by prosecutors and the reforms agreed to in settlements have a precedential impact on similarly situated firms. However, unlike the common law, there is no adjudication and no meaningful judicial review. Companies and consulting firms track enforcement activity and heed the elements of compliance emphasized by enforcement authorities (PricewaterhouseCoopers 2014). Settlements thus have a strong signaling effect on the market as a whole as companies are pushed to adopt compliance functions similar to peer firms. Trade associations and industry-wide working groups, such as the "Wolfsburg Group" in the banking sector, can accelerate this process. The result is "compliance creep," a process by which compliance enhancements at one firm are soon mimicked across an entire industry.

[1] The seven basic factors are: (1) rules, (2) high-level engagement and appropriate delegation, (3) diligence in hiring, (4) communication and training, (5) monitoring and testing, (6) alignment of incentives, and (7) appropriate remediation. (Sentencing Guidelines, §8B2.1(b))

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In spite of recent efforts to subject compliance to empirical testing (Armour, Garrett, Gordon, and Min, 2020; Armour, Gordon, and Min, 2020), the effect of compliance enhancements on corporations remains unknown and largely untested (Griffith 2016). Still, one effect is clear. By creating strong incentives for firms to adopt compliance programs and taking the additional step of defining what specific features make a compliance program effective, government enforcement authorities have embedded within firms an agent to carry out their enforcement agenda. Corporate compliance departments owe their existence and their design in large part to an exogenous authority. This creates unique incentives for the agents operating within them, as described in the next part.

3. Compliance Agents

Given that compliance officers owe their professional existence, in large part, to the government, it is worth asking to whom these agents are accountable. The government? Or the firm? As we shall see, these questions cannot be answered unambiguously. As a result, it is perhaps most accurate to see compliance officers as accountable both to the firm and to the government. This dual accountability has predictable effects on the incentives of compliance officers, rendering them especially receptive to the policy agenda of prosecutors and regulators.

The compliance department, like any other corporate function, is administered by agents: the CCO and her staff. However, unlike other corporate officers who serve shareholder interests, compliance officers are not simply accountable to the interests of shareholders. As we have seen, prosecutors and regulatory authorities insist that compliance departments carry out a monitoring and enforcement agenda inside the firm. Failure to do so may lead to consequences not only from the firm, but also from the government or regulator. In perhaps the most famous example, the Financial Crimes Enforcement Network (part of the Treasury Department), sought a $1 million penalty and a bar from future financial industry employment against a compliance officer for "failing to ensure that his company abided" anti-money laundering law.[2] Likewise, FINRA fined and suspended a compliance officer at Brown Brothers Harriman & Co. for failing to detect and deter transactions potentially linked to money laundering.[3] Although personal liability remains rare, the replacement of compliance personnel in the wake of a governmental investigation is not.[4] Compliance officers are therefore likely to feel accountable to

[2] Press Release, FinCEN Assesses $1 Million Penalty and Seeks to Bar Former MoneyGram Executive from Financial Industry, Dec. 18, 2014, available at: https://www.fincen.gov/sites/default/files/news_release/20141218.pdf.

[3] Finra Press Release, FINRA Fines Brown Brothers Harriman A Record $8 Million for Substantial Anti-Money Laundering Compliance Failures, Feb. 5, 2014, available at https://www.finra.org/newsroom/2014/finra-fines-brown-brothers-harriman-record-8-million-substantial-anti-money-laundering.

[4] See, e.g., Department of Justice Press Release, BNP Paribas Agrees to Plead Guilty and to Pay $8.9 Billion for Illegally Processing Financial Transactions for Countries Subject to U.S. Economic Sanctions, June 30, 2014, available at https://www.justice.gov/opa/pr/bnp-paribas-agrees-plead-guilty-and-pay-89-billion-illegally-processing-

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governmental regulators and enforcers as much as to the company employing them. As a result, they have their own incentives promptly to report out any wrongdoing within the firm, lest they face personal penalties when it is later uncovered.

In this way, unlike other agents of the firm, compliance officers' first responsibility is not to maximize shareholder wealth but rather to maximize compliance. Doing so efficiently and effectively, of course, may have salutary effects on shareholder wealth. But at least so far as the government is concerned, compliance officers are there to ensure compliance full stop, without regard to efficiency. As a result, compliance officers maximize compliance first, shareholder wealth second, if at all.

Compliance officers also have their own incentives, including growth and advancement within their profession, to promote compliance beyond what shareholders might prefer. One does not advance in any field by downplaying its importance. A better strategy would be to regularly promote the importance of the field, emphasize its complexity, and claim special knowledge of what works and what does not. Compliance officers do all of this.[5] Moreover, their dual accountability—to the government on one hand, to the firm on the other—may assist them in this regard. Just as a servant of two masters is accountable to none, compliance agents can cite their government mandate when called to account by the firm and the interests of the firm when called to account by the government (Easterbrook & Fischel 1991).

One way that compliance officers have increased their own stature within the firm is by taking on the role of interpreting the rules with which the firm must comply. To use the dichotomy with which we began, compliance has taken on answering *what* as well as *how*. This authority is formalized in firms that separate compliance from legal, often at the behest of a regulator (DeStefano 2013). But even where compliance is not formally separated from legal, compliance may be able to expand its authority by interpreting regulatory guidance and embedding the interpretation as part of the firm's compliance program.

Consistent with this account, a recent study finds that compliance officers often fail to distinguish between regulatory guidance, which is formally non-binding, and regulatory rules, which have the force of law (Parrillo 2019). Instead, compliance officers often follow guidance as though it were the law, using regulatory pronouncements as sources of authority to guide

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financial (noting that replacement of employees in the compliance department); Department of Justice Press Release, HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit $1.256 Billion in Deferred Prosecution Agreement, Dec. 11, 2012, available at https://www.justice.gov/opa/pr/hsbc-holdings-plc-and-hsbc-bank-usa-na-admit-anti-money-laundering-and-sanctions-violations (noting the claw-back of compensation paid to compliance officers in the wake of corporate misconduct).

[5] For example, compliance officers often write and speak to emphasize the complexities of compliance design and lessons learned from major enforcement actions. *See, e.g.*, The FCPA Blog: News and Commentary about White-Collar Crime, Enforcement, and Compliance, http://www.fcpablog.com/ (featuring posts from compliance officers and experts in compliance).

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internal compliance policies and procedures. In doing so, however, they are not complying with law but rather with a regulator's view of what the law is or ought to be. For example, the bribery of foreign officials is made illegal by a statute, the Foreign Corrupt Practices Act. That statute is enforced by the Department of Justice and the Securities and Exchange Commission (the "enforcers"). That much is law. The enforcers have also promulgated guidance on how they intend to implement the law (FCPA Resource Guide 2012). This guidance contains legal interpretations as well as specific recommendations, with examples, on how to design and conduct compliance programs consistent with the enforcers' objectives. The guidance is not law. In fact, it contains several highly contestable legal claims (Koehler 2012). Moreover, the enforcers often go further in making pronouncements, often in speeches, about specific features that may render a compliance program effective or ineffective (e.g., Caldwell 2014). Such pronouncements are another form of guidance, not law.

Whether a business organization ought to comply with guidance as well as law is a complex business decision. It requires distinguishing between the two, weighing the costs and benefits of the alternatives, factoring in probabilities, and determining whether the benefits exceed the costs. Compliance officers who view their role as maximizing compliance, not firm value, and who are at least partially accountable to an outside government enforcer may have a tendency to decide these issues in one way—that is, in favor of greater compliance. Indeed, compliance officers may simply incorporate guidance into compliance policies and training modules. This harms the firm insofar as the costs of complying with guidance exceed the benefits. But more important than the imposition of inefficiencies on the firm, the structure of compliance and the incentives of compliance officers create significant rule of law concerns, explored in the next part.

4. Compliance and the Rule of Law

The rule of law means rulers must also follow rules. Under U.S. law, the Administrative Procedure Act ("APA") sets forth procedures regulators must follow in passing rules affecting regulated entities. Among other things, the APA requires regulatory agencies to subject proposed rules to a set of constraints before they can be formally enacted. These include a cost-benefit analysis designed to ensure the efficacy of the rule as well as a period of notice and comment, designed to expose the proposed rule to the democratic process. Each of these is an important constraint on administrative rule-making, and rules have been overturned for failing under either or both requirements.[6] Guidance – regulatory pronouncements issued in the form of

[6] For decisions overturning rules for failure to conduct a persuasive cost-benefit analysis, *see* Bus. Roundtable v. SEC, 647 F.3d 1144, 1151 (D.C. Cir. 2011) (vacating proxy access proposal on basis of flawed cost-benefit analysis because the SEC "discounted the costs of [the proposed rule]—but not the benefits"); Am. Equity Inv. Life Ins. Co. v. SEC, 613 F.3d 166, 179 (D.C. Cir. 2010) (vacating proposed rule for failure to conduct adequate cost-benefit analysis, specifically failure "to determine whether, under the existing regime, sufficient protections existed to

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advisory manuals, policy statements, interpretative letters, FAQs, and so on – is formally exempted from these processes.

Rule of law concerns arise because guidance, although technically non-binding, often has the same effect as administrative rule-making (Crews, Jr. 2017).[7] This may be for several reasons, centrally including the development of compliance (Parrillo 2019). As discussed above, compliance officers not only treat guidance as binding, they owe their existence to and interpret their mandate as derived from the regulators themselves. The compliance department, in other words, operates as a conduit through which administrative agencies can influence firm conduct. The problem is that when agencies do so through guidance rather than through rule-making, they exceed the authority conferred upon them by statute.

The pronouncements of prosecutors and regulators, whether they interpret the law or suggest "effective" compliance structures, are neither checked by expert cost-benefit analysis nor by the democratic process of notice and comment. Instead, regulatory pronouncements are silently operationalized, through the intermediation of compliance, without public process or demonstration of efficacy. This is an enlargement of regulatory authority beyond the bounds of the law. Moreover, when the imposition comes from a prosecutor rather than a regulator, separation of powers concerns are raised as well. Prosecutors acting as rule-makers amounts to the executive usurpation of a legislative role. "The model of 'prosecutor-slash-regulator' is in tension with a government based on strict separation of powers" (Barkow 2011).

This enlargement of regulatory and prosecutorial authority may not be wholly intentional. Regulatory and enforcement agents may not set out to enlarge their powers by acting strategically through the use of guidance (Parrillo 2019). But whether it is intentional or not, the compliance conduit for regulatory rule-making is in tension with the rule of law and constitutional values.

5. A Structural Solution to a Structural Problem

A simple way of ameliorating the situation would be to strip compliance of the authority to say *what* is lawful, leaving them with only the power to say *how* to comply. The best way of doing this would be to make compliance subservient to an organ of the firm that has both the

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enable investors to make informed investment decisions and sellers to make suitable recommendations to investors"); Chamber of Commerce v. SEC, 412 F.3d 133, 136 (D.C. Cir. 2005) (holding that the SEC violated the Administrative Procedure Act "by failing adequately to consider the costs mutual funds would incur in order to comply with the conditions"). For a canonical case overturning a rule for insufficient notice and comment, see United States v. Nova Scotia Food Products Corp., 568 F.2d 240 (2d Cir. 1977).

[7] This concern forms the basis of two recent executive orders. Exec. Order, "Promoting the Rule of Law Through Improved Agency Guidance Documents" (Oct. 9, 2019); Exec. Order, "Promoting the Rule of Law Through Transparency and Fairness in Civil Administrative Enforcement and Adjudication" (Oct. 9, 2019).

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informational resources to interpret the requirements of law and the incentive to do so from the perspective of the firm's shareholders, rather than an outside authority. The relevant organ of the firm, of course, is the legal department. The simplest way to address the problems raised above is thus to make the CCO report to the GC.

Subordinating compliance to legal would make the officer charged with determining how to comply report separately to an officer charged with interpreting and applying the law. The GC has adequate training and information to understand the distinction between rules and guidance. Moreover, as a legal advisor, the GC is accustomed to complex risk-reward calculations. Most importantly, because her authority flows from shareholders, not prosecutors or other external enforcement agents, the GC is more likely to perform the cost-benefit calculation from the shareholders' perspective, ignoring guidance or seeking exemptive relief when compliance is not cost-justified to the firm.

This is not to suggest that GCs are perfect. Indeed, GCs may also use regulatory guidance as an interpretive tool. But because GC accountability is not ambiguous in the same way as CCO accountability, GCs have less incentive to over-comply or over-represent the authority of guidance. As legal advisors, the GCs role is to counsel management on the risks associated with various alternatives, not to ensure a particular course for the organization.

Unfortunately, the recent momentum in compliance has been toward the separation of compliance from legal and the further insulation of compliance from other departments of the firm (DeStefano 2013). This is a regrettable development that should be reversed in order to prevent the compliance function from becoming a conduit through which the administrative state unaccountably enlarges its authority. In order to reverse this trend, however, the government must stop insisting upon the separation of compliance from legal. More broadly, the government should stop telling firms how to do compliance. The government should no longer seek to define "effective" compliance in the Sentencing Guidelines, the U.S. Attorneys' Manual, or various other guidance documents. And prosecutors and enforcement agents should stop seeking to extract compliance reforms in settlement.

Restricting the government's authority to say what effective compliance is and is not would eliminate much of its ability to operate beyond the confines of law. Without the threat that failure to implement a proposal will render a compliance program "ineffective," pronouncements made as guidance will lose much of their de facto mandatory nature. But government exit from compliance does not mean exit from enforcement. If the government got out of the business of corporate reform, it would still have the power to enforce the law to its fullest extent. It would still be able to impose massive penalties. And it would still have the power to settle and to give credit for cooperation. It simply could not insist upon compliance reforms. In sum, setting such limits does not mean allowing firms to break the law but rather ensuring that the government also follows it.

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