Compliance Gatekeepers

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Abstract

What determines the effectiveness of corporate compliance programs, and who is accountable when they fail? Scholars and policymakers tend to answer these questions by focusing on internal compliance actors: directors, CEOs, general counsels, chief financial officers, and chief compliance officers. Yet in reality, all these corporate insiders rarely perform compliance tasks on their own. They rather heavily rely on outside compliance advisors. In this Article we spotlight the understudied role of outside compliance advisors and make the following three contributions. First, we document the various functions that outside compliance gatekeepers play these days: from designing reporting systems, to conducting internal investigations and monitorships, to performing "racial equity audits" and verifying ESG disclosures. Along all these dimensions, there exists a gap between the high level of expectations for compliance gatekeepers to improve corporate behavior and their low levels of accountability for compliance failures. Second, we examine the causes of compliance gatekeepers' lack of accountability. Compliance gatekeepers rarely face litigation, even after colossal compliance failures, because an amalgamation of doctrines set a very high pleading hurdle across all potential claims against them. Private ordering is ineffective too. The buyers in the market for compliance gatekeeping – namely, corporate insiders – do not necessarily want outside compliance gatekeepers to hinder their company from making profits by skirting regulations in real time. Nor do corporate insiders want outside gatekeepers to probe their internal affairs diligently after the fact and place the blame for corporate wrongdoing at their feet. By paying outside compliance gatekeepers with shareholders' money, corporate insiders buy plausible deniability for themselves. From the sellers' (gatekeepers') perspective, it is convenient to ramp up expectations while not being too stringent with their clients, because this keeps a newfound revenue stream alive and growing. The gap between high expectations and somber reality may therefore be a feature rather than a bug. Finally, we propose concrete policy measures that could improve corporate compliance. For example, public enforcers need to rethink the practice of providing lenient treatment to corporate wrongdoers who rely on outside experts. Credit to wrongdoers should be conditioned on outside experts facing a meaningful threat of liability or at minimum transparency. Courts need to rethink the applications of doctrines such as "in pari delicto," which blocks claims of professional negligence and breach of contract against gatekeepers. And corporate law courts should interpret shareholders' right to inspect their company's books more liberally, so that it includes access to documents pertaining to gatekeepers' work, thereby enabling shareholders to investigate potential gatekeeper misconduct.

Keywords: Compliance, Corporate Law, Corporate Governance, Gatekeepers, Oversight Duties, Caremark, In Pari Delicto, Aiding-and-Abetting, Inspection Rights, Reputation, Derivative Actions, Shareholder Litigation, Third-Party Advisors, Demand Futility, Monitorship, Internal Investigations

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What determines the effectiveness of corporate compliance programs, and who is accountable when they fail? Scholars and policymakers tend to answer these questions by focusing on internal compliance actors: directors, CEOs, general counsels, chief financial officers, and chief compliance officers. Yet in reality, all these corporate insiders rarely perform compliance tasks on their own. They rather heavily rely on outside compliance advisors. In this Article we spotlight the understudied role of outside compliance advisors and make the following three contributions.

First, we document the various functions that outside compliance gatekeepers play these days: from designing reporting systems, to conducting internal investigations and monitorships, to performing "racial equity audits" and verifying ESG disclosures. Along all these dimensions, there exists a gap between the high level of expectations for compliance gatekeepers to improve corporate behavior and their low levels of accountability for compliance failures.

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INTRODUCTION

Compliance has become a critical corporate governance issue.[1] Companies are facing increased societal demands, heavier regulatory burdens, and a marked uptick in enforcement.[2] In response, companies pour

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[1] Sean J. Griffith, *Corporate Governance in an Era of Compliance*, 57 WM. & MARY L. REV. 2075, 2077 (2016). "Compliance" is defined here as the set of internal processes firms employ to ensure that their behavior falls in line with applicable laws or with broader societal expectations.

[2] Leo E. Strine, Jr., Kirby M. Smith, & Reilly S. Steel, *Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy*, 106 IOWA L. REV. 1885 (2021) (on increased societal demands); John F. Savarese et al., *Wachtell Lipton Discusses White-Collar and Regulatory Enforcement: What Mattered in 2020 and What to Expect in 2021*, CLS BLUE SKY BLOG (Feb. 10, 2021),

billions of dollars into compliance programs meant to prevent and detect wrongdoing by their employees.[3] Yet there remains much skepticism regarding the effectiveness of these compliance programs.[4] In one major corporate debacle after another, companies that boasted an elaborate compliance program are caught engaging in elaborate wrongdoings and coverups. And systematic empirical studies suggest that the gigantic investment in compliance is not serving its purported purpose of curbing corporate wrongdoing and promoting overall welfare.[5]

What determines the effectiveness of corporate compliance? Who is accountable for compliance failures, and how can we mitigate them? This Article approaches these questions by focusing on the understudied role of outside compliance advisors. Corporate governance scholars, regulators, and judges tend to focus on internal compliance actors: debating what the scope of director oversight duties should be, how to structure board committees and design executive pay packages, and whether to divide the roles of Chief Compliance Officer and General Counsel.[6] Yet in reality all these corporate insiders – directors, executive managers, chief compliance officers, and general counsels – rarely perform compliance tasks on their own. They rather heavily rely on outside compliance advisors.

Outside compliance professionals play a key role at every stage of corporate compliance: from prevention, to monitoring and detection, to investigation and remediation. Indeed, virtually every large law firm or accounting firm these days sells various "compliance services": from advising companies on how to design reporting systems to meet evolving regulatory demands, to conducting internal investigations and negotiating

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https://clsbluesky.law.columbia.edu/2021/02/10/wachtell-lipton-discusses-white-collar-and-regulatory-enforcement-what-mattered-in-2020-and-what-to-expect-in-2021 (on increased regulatory demands); Asaf Eckstein & Gideon Parchomovsky, *The Agent's Problem*, 70 DUKE L.J. 1509, 1518–1525 (2021) (linking the dramatic rise in compliance costs to the dramatic uptick in enforcement).

[3] Eugene Soltes, *Evaluating the Effectiveness of Corporate Compliance Programs: Establishing a Model for Prosecutors, Courts, and Firms*, 14 N.Y.U. J.L. & BUS. 965, 969 (2018) (providing an estimate of compliance costs).

[4] *See generally* Benjamin van Rooij & Melissa Rorie, *Measuring Compliance: The Challenges in Assessing and Understanding the Interaction between Law and Organizational Misconduct*, *in* MEASURING COMPLIANCE (2022).

[5] *Id*; William R. Heaston, *Copycat Compliance and the Ironies of "Best Practices,"* 24 U. PA. J. BUS. L. 750, 752 (2022) (compiling references for the constantly increasing expenditures of compliance, and the colossal costs of compliance failures).

[6] Vikramaditya Khanna, *An Analysis of Internal Governance and the Role of the General Counsel in Reducing Corporate Crime*, *in* RESEARCH HANDBOOK ON CORPORATE CRIME AND FINANCIAL MISDEALING 282 (Jennifer H. Arlen, ed., 2018) ("Lately, scholarly attention has focused on internal factors such as Board and Audit Committee composition, executive compensation"); Veronica Root Martinez, *The Outsized Influence of the FCPA?*, 2019 U. ILL L. REV. 1205, 1222 (2019) (describing the focus of the extant literature); Virginia Harper Ho, *Board Duties: Monitoring, Risk Management & Compliance*, COMPARATIVE CORPORATE GOVERNANCE 247 (Afra Afsharpour & Martin Gelter, eds., 2021) (same); .

with regulators for leniency once wrongdoing has been uncovered.[7] In fact, in the last couple of years the role of outside compliance advisors has expanded beyond legal compliance and into Environmental, Social and Governance (ESG) issues. For example, large companies now regularly hire outside consultants to conduct "racial equity audits" or "labor conditions audits."[8]

The increased reliance on outside compliance professionals is somewhat inevitable. The size and complexity of modern corporations means that corporate boards, with their inherently limited bandwidth and expertise, do not have the capacity to keep all oversight functions in house and increasingly rely on outside experts.[9] Similar dynamics are in play with public enforcers. Detecting and proving culpability inside large organizations often proves too difficult given regulators' scarce resources.[10] As a result, regulators resort to incentivizing companies to rely on outside compliance professionals. For example, the Department of Justice often conditions the credit it gives to a corporation on the prosecuted company nominating an independent third-party monitor.[11] Corporate law courts similarly give credit to boards that rely on outside professionals to fulfill directors' oversight duties.[12] Outside compliance professionals are thus perceived as "gatekeepers" in the broad sense of the word, supposedly serving as "the thin blue line between insatiable corporate appetite for success at any cost and the demands of the government and investors that companies not even test the line of legality."[13]

The stakes of understanding the role that these compliance gatekeepers play could therefore not be higher. Corporate compliance will be effective only to the extent that outside compliance gatekeepers are effective

[7] Donald C. Langevoort, *Cultures of Compliance*, 54 AM. CRIM. L. REV. 933 (2017); Peter J. Henning, *The New Corporate Gatekeeper*, 62 WAYNE L. REV. 29, 62 (2016).
[8] *Infra* notes 36–42 and the accompanying text.
[9] Lisa Fairfax, *Managing Expectations: Does the Directors' Duty to Monitor Promise More than it can Deliver?*, 10 U. ST. THOMAS L.J. 416, 441 (2012).
[10] Roy Shapira, *The Challenge of Holding Big Business Accountable*, 44 CARDOZO L. REV. 203, 221 (2022).
[11] *See, e.g.*, Charles D. Weisselberg & Su Li, *Big Law's Sixth Amendment: The Rise of Corporate White-Collar Practices in Large U.S. Law Firms*,53 ARIZ. L. REV. 1221, 1269 (2011).
[12] DGCL §141(e); *infra* note 149 and the accompanying text (reliance on third-party advisors is evidence that the board fulfilled its oversight duty); Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134 (Del. Ch. 1994), aff'd, 663 A.2d 1156 (Del. 1995) (reliance on experienced counsel is evidence of good faith and the overall fairness of a deal process).
[13] Henning, *supra* note 7. Various terms are used to describe outside compliance professionals, such as "independent examiners," "corporate compliance monitors," and "regulatory advisory units." Jennifer Arlen & Marcel Kahan, *Corporate Governance Regulation through Nonprosecution*, 84 U. CHI. L. REV. 323, 342 (2017); Vikramaditya Khanna & Timothy Dickinson, *The Corporate Monitor: The New Corporate Czar?*, 105 MICH. L. REV. 1713, 1720-26 (2007). We opt to use here the umbrella term "compliance gatekeepers" to underscore their purported role in curbing violations of law, and to draw parallels to an extant literature on other types of corporate gatekeepers.

at their jobs. Yet for various reasons the role of outside compliance gatekeepers has thus far remained understudied.[14] This Article narrows the gap in our understanding of compliance gatekeepers by making the following three contributions.

First, the Article documents the outsized role that outside compliance gatekeepers play these days. In particular, we juxtapose the high levels of expectations for outside gatekeepers to improve corporate compliance with their low levels of accountability for compliance failures.

Second, the Article examines the causes of this apparent lack of accountability. Corporate insiders face a meaningful threat of litigation and reputational fallouts whenever their compliance programs fail, as is evident from doctrines such as "the responsible corporate officer" in criminal law[15] and "*Caremark* duties" in corporate law.[16] By contrast, the outside consultants that insiders rely on almost always emerge from failures unscathed. The reason is a unique combination of perverse incentives and doctrinal hurdles.

Consider first the lack of litigation.[17] An amalgamation of doctrines set a very high pleading hurdle in litigation against compliance gatekeepers. Across all potential claims – from securities law, to contract and tort law, to aiding-and-abetting fiduciary duty obligations in corporate law – plaintiffs must show bad faith on the part of the gatekeepers in order to advance past the motion to dismiss. The only way for plaintiffs to survive such a scienter-based pleading hurdle is to have access to internal documents showing what the gatekeepers knew in real time. Yet those who have access to internal documents, namely, the corporate insiders, do not have incentives to fight gatekeepers in court, if for no other reason than out of fear that the latter will air their dirty laundry in public. And those who have incentives to recoup harms and hold gatekeepers accountable, namely, public shareholders, are blocked from accessing internal documents. As a result, compliance gatekeepers are rarely named as defendants in shareholder litigation following compliance failures.

What about private ordering, then? Compliance gatekeepers would surely like to maintain a reputation for being diligent. And corporate insiders would surely want to get bang for their compliance-consulting buck. One could therefore surmise that even without a meaningful threat of legal

[14] We conjecture that one reason for the dearth of legal scholarship on compliance gatekeepers is the dearth of litigation against them. Part II *infra* elaborates.
[15] United States v. Dotterweich, 320 U.S. 277 (1943); Samuel W. Buell, *The Responsibility Gap in Corporate Crime*, 12 CRIM. L. PHIL. 471, 473 (2018). Further, the Department of Justice (DOJ)'s Yates memorandum also signifies a commitment to hold top corporate insiders accountable for corporate wrongdoing. *See generally* Gideon Mark, *The Yates Memorandum*, 51 UC DAVIS L. REV. 1589 (2018).
[16] *In re* Caremark Int'l Inc. Deriv. Secs. Litig., 698 A.2d 959 (Del. Ct. Ch. 1996).
[17] Section II.A. *infra.*

sanctions, compliance gatekeepers will be deterred from shirking or colluding due to the threat of informal, market sanctions. Yet such an argument ignores the perverse incentives and information asymmetries in our context.

The top corporate managers who contract with outside compliance gatekeepers may lack the incentives to hold gatekeepers accountable. There is often a divergence between what public shareholders want from compliance gatekeepers and what the shareholders' agents do. Because compliance failures could cause the company colossal financial and reputational harms,[18] shareholders would want gatekeepers to properly install and monitor compliance programs, and to vigorously investigate compliance failures. By contrast, top corporate managers whose compensation is tied to current stock prices may not necessarily want gatekeepers to stop the company from making short-term profits by skirting regulations.[19] And they would certainly not want gatekeepers to probe diligently after the fact and trace the blame for corporate wrongdoing all the way to the top of the corporate hierarchy.

As for compliance advisors, they operate in a fast-growing market and focus on marketing additional services to an existing client pool. As salesmen, it may be hard for them to be objective.[20] To the outside world, gatekeepers wish to maintain a reputation for being diligent. But to the corporate managers that hire them, gatekeepers may wish to maintain a reputation for being lenient. In fact, it is in the interest of managers that gatekeepers play this two-sided reputation game. Insiders would want their outside compliance advisors to have a reputation for integrity, because such a reputation is what prompts prosecutors and investors to give the company credit when it hires an outside gatekeeper.[21]

The upshot is counterintuitive: the accountability gap may very well be a feature rather than a bug in the market for compliance consulting and internal investigations. Both direct parties to the compliance gatekeeping transaction have an interest in keeping up appearances, and keeping down actual performance. They want to present a picture to the outside world of

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[18] *See* Eckstein & Parchomovsky, *supra* note 2, at 1518-1525 (on the legal costs of compliance failures); Jonathan M. Karpoff, D. Scott Lee & Gerald S. Martin, *The Cost to Firms of Cooking the Books*, 43 J. FIN. QUANT. ANAL. 581 (2008) (on the reputational costs of compliance failures); David M. Uhlmann, *Deferred Prosecution and Non-Prosecution Agreements and the Erosion of Corporate Criminal Liability*, 72 MARYLAND L. REV. 1295, 1335–6 (2013) (on the stigmatizing costs of compliance failures).

[19] John Armour, Jeffrey Gordon, & Geeyoung Min, *Taking Compliance Seriously*, 37 YALE J. REG. 1, 3 (2020) (noting that the structure of executives' and directors' pay packages incentivizes them to short-change compliance in the pursuit of short-term financial benefit).

[20] JOHN C. COFFEE JR., GATEKEEPERS: THE PROFESSIONS AND CORPORATE GOVERNANCE 162 (2006).

[21] What enables gatekeepers to play the two-sided reputation game is the severe information asymmetries in this market. Unlike in more traditional gatekeeping contexts such as auditing financial statements, quality information on what happened and to whom to attribute failures is extremely hard to come by. Section II.B.1 *infra*.

outside compliance gatekeepers being diligent and demanding with their corporate clients. But they also want to keep making profits while escaping accountability. By paying outside compliance gatekeepers with shareholders' money, corporate insiders buy plausible deniability for themselves.[22] Insiders can say that they relied on the advice given to them by well-reputed, highly paid outsiders. Outsiders, in turn, can say that they relied on the information given to them by insiders.

The ones suffering from this endless loop of plausible deniability are dispersed publics: from outside shareholders who foot the bill for hefty consulting fees and heavy fines, to community members who suffer from the effects of pollution, to users who have their privacy violated, and so on.

This is where the Article's third and final set of contributions comes in. We propose concrete policy measures that could change the existing equilibrium and improve corporate compliance. For example, public enforcers need to rethink the practice of providing lenient treatment to corporate wrongdoers because the latter relied on outside experts. Credit to wrongdoers should be conditioned on outside experts facing a meaningful threat of liability or at minimum transparency. Courts need to carve out exceptions to an obscure-yet-powerful doctrine named "*in pari delicto*," which currently blocks claims in professional negligence and contracts against gatekeepers. And corporate law courts should interpret shareholders' right to inspect their company's books and records more liberally, so that it includes access to documents pertaining to gatekeepers' work, thereby enabling shareholders to investigate potential gatekeeper misconduct. To quell fears that such measures would lead to gatekeeper overdeterrence, we propose combining them with capping damages and applying comparative negligence and indemnification rights. Such a combination of measures would strike a balance between reviving litigation as a conduit for gatekeeper accountability (flushing out information on gatekeeper misconduct) and not subjecting gatekeepers to excessive liability risk.

A note on scope and terminology is in order from the outset. Blaming gatekeepers for corporate debacles is not new.[23] Neither is the notion of an

[22] As will become clearer throughout the Article, the reality is more nuanced, as there exist circumstances in which shareholders may benefit from compliance gatekeepers' leniency. In other words, the issue is not always an agency problem, but sometimes an externality problem: if both managers and their shareholders benefit from the company skirting compliance, both managers and their shareholders may benefit from a compliance gatekeeper who turns a blind eye to compliance failures or does not probe them too hard. *See, e.g.*, Roy Shapira & Luigi Zingales, Is Pollution Value Maximizing? The DuPont Case (NBER Working Paper No. 23866, 2017), www.nber.org/papers/w23866 (providing a detailed case-study showing the conditions under which cheating can pay even for long-term shareholders).

[23] Arthur B. Laby, *Differentiating Gatekeepers*, 1 BROOK. J. CORP. FIN & COM. L. 119 (2006).

"expectations gap."[24] However, the extant literature has focused on other types of gatekeeping, such as auditors reviewing the accuracy of financial statements, or lawyers and investment bankers requiring sufficient disclosures when companies sell securities to the public.[25] These are "transactional gatekeepers," who usually monitor the company's financial performance. We shift focus to "compliance gatekeepers," who monitor the company's adherence to legal demands more broadly.[26] The former mostly serve investors qua investors. The latter serve broader societal interests: society relies on them to mitigate harmful corporate behaviors ranging from polluting, to bribing public officials, to violating users' privacy. The differences between the two contexts translate into different information, incentives, and doctrinal problems. In fact, even within the narrow group of compliance gatekeepers there exist important differences between those who perform "ex ante" compliance tasks, such as designing compliance programs, and those who perform "ex post" compliance tasks, such as conducting internal investigations or negotiating with regulators for leniency. Our framework would shed light on this understudied variation between different gatekeeping functions.

The Article proceeds in four parts. Part I describes the problem: outside gatekeepers play an outsized role in corporate compliance, yet they are seemingly unaccountable for compliance failures. Part II explains the causes of this problem: corporate insiders do not want to hold outsiders accountable, and outside shareholders face insurmountable doctrinal hurdles when trying to do so. Part III offers ways to mitigate the problem, such as by reviving the threat of corporate law litigation against misbehaving gatekeepers. The Conclusion clarifies our contributions by juxtaposing them with the extant literature and acknowledges the limitations of our analysis.

I. BACKGROUND: THE RISE OF COMPLIANCE GATEKEEPING

The concept of corporate risk management has been constantly broadening.[27] Corporate managers have traditionally concerned themselves with operation problems and financial breakdowns that could disrupt the

[24] Carl D. Liggio, *The Expectations Gap: The Accountant's Waterloo*, 3 J. CONTEMP. BUS. 27 (1974) (coining the term); John McEnroe & Stanley Martens, *Auditors' and Investors' Perceptions of the Expectation Gap*, ACCT. HORIZONS 345 (2001) (empirically documenting the gap).
[25] COFFEE, *supra* note 20, at 162-63.
[26] Another distinction is that the extant literature focuses on "gatekeeper" in the narrow sense of the word as someone who can shut the gate to a transaction (such as by refusing to provide a written opinion). We, by contrast, focus on "gatekeeper" in the broad sense of the word as someone who can prevent a primary wrongdoer from engaging in wrongdoing. *See generally* Reinier Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. ECON. & ORG. 53 (1986).
[27] *See, e.g.*, James A. Fanto, *The Professionalization of Compliance: Its Progress, Impediments, and Outcomes*, 35 NOTRE DAME J.L. ETHICS & PUB. POL'Y 183, 191 (2021).

company's core business activities. Starting in early 2000s, following a string of major collapses such as Enron's, companies started heavily investing in internal controls to mitigate risks arising from financial reporting and overvaluation of stocks. Over the 2010s and following the 2008 financial crisis, the scope of risk grew further to encompass issues such as whether the company's executive pay packages reward excessive risk taking. Nowadays, risk frameworks are broadening again, to deal with increased societal demands and regulatory requirements. Whenever risk frameworks expand, corporate insiders turn to outside professionals to provide advice (human capital), legitimacy (reputational capital), and connections (social capital). The result is a constant expansion of the role of compliance gatekeepers.

This Part provides the necessary background on the role of compliance gatekeepers. Section A canvasses the different types of compliance gatekeeping. Section B illustrates just how much is riding on their effectiveness, namely, how companies, regulators, and the public are seemingly counting on compliance gatekeepers to curb corporate wrongdoing. Section C spotlights the surprising lack of accountability of compliance gatekeepers when corporate wrongdoing nevertheless occurs on their watch.

A. Outside Compliance Gatekeepers Play an Outsized Role in Corporate Compliance

Corporate compliance efforts occur in several stages: from prevention, to detection, to investigation, to remediation.[28] Outside compliance gatekeepers play a crucial role in all of these: from the initial setup to the ongoing monitoring, to postmortem investigations.[29]

Consider "compliance intelligence" first. Large companies face numerous, ever-changing risks. To ensure effective compliance, they need to identify the risks that are critical to them and build reporting systems that reflect this prioritization.[30] Companies often turn to outside consultants to help them with identifying regulatory enforcement trends and company-specific risks, and then design and set up systems to prevent, detect, and report on said risks.[31]

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[28] On the different stages of corporate compliance *see generally* Veronica Root, *The Compliance Process*, 94 IND. L.J. 203 (2019); Langevoort, *supra* note 7, at 939.

[29] We roughly divide these types of compliance gatekeeping into preventing wrongdoing ex ante and helping the firm deal with wrongdoing after it has taken place, ex post. But we do not wish to belabor this point: if "ex post" compliance gatekeepers help top insiders get off the hook by conducting investigations that only point the finger at lower-level employees, their work also affects (lowers) the chances of reducing corporate misconduct ex ante.

[30] Stephen M. Bainbridge, Caremark *and Enterprise Risk Management*, 34 J. CORP. L. 967, 969 (2009).

[31] Todd Haugh, *The Criminalization of Compliance*, 92 NOTRE DAME L. REV. 1215, 1222-3 (2017). For an early account of the rise of a "third-party assurance industry" *see* Margaret M. Blair, Cynthia

Once the systems are in place, they need to be constantly monitored and evaluated.[32] Here as well, companies have been increasingly turning to outside advisors to provide "compliance monitoring," such as conducting audits and surveillance to examine whether the systems are doing a good job of ferreting out wrongdoing.[33]

Then, when wrongdoing nevertheless occurs (no compliance program is perfect), companies turn to outside professionals to help them with "compliance investigations," and with shaping companies' responses to failure.[34] Companies delegate to outsiders the power to investigate what and how things went wrong, and sketch ways to remediate problems and redesign the reporting systems going forward. The hope is that when an "internal investigation" is conducted by an outside expert, it will better achieve the two goals of (1) generating valuable information that the board could then use to improve corporate governance going forward, and (2) signaling to employees and regulators the company's commitment to ferret out wrongdoing and cooperate with government investigatory efforts.[35]

A related, increasingly common practice is the appointment of a "monitor," as part of a company's deferred or non-prosecution agreement with public enforcers.[36] The monitor, who is supposedly independent of the host organization, regularly advises its host organization on how to implement changes to their compliance program and audits the host's compliance with the agreement that it entered with the government.[37] As Section I.B below details, enforcement authorities often expect companies to

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A. Williams & Li-Wen Lin, *The New Role for Assurance Services in Global Commerce*, 33 J. CORP. L. 325, 329-332 (2008).

[32] The DOJ requires companies to review and adapt their compliance programs based upon lessons learned from their own misconduct and from that of their peer. *See* U.S. DEPARTMENT OF JUSTICE, CRIMINAL DIVISION, EVALUATION OF CORPORATE COMPLIANCE PROGRAMS 14-15 (2020).

[33] *See, e.g.*, *See* SUSANNAH HAMMOND & MIKE COWAN, COST OF COMPLIANCE: SHAPING THE FUTURE (2021) (a practitioner-based survey, indicating that companies are increasingly turning to outside experts to provide assurances on their compliance processes in real time).

[34] Griffith, *supra* note 1, at 2090; Weisselberg & Li , *supra* note 11, at 1269.

[35] Miriam H. Baer, *When the Corporation Investigates Itself*, *in* RESEARCH HANDBOOK OF CORPORATE CRIME AND FINANCIAL MISLEADING 308, 310 (Jennifer Arlen, ed., 2018) (detailing the two goals of internal investigations).

[36] For early writings on the rise of independent monitors see Khanna & Dickinson, *supra* note 13. For a recent account see Veronica Root Martinez, *Greater Publicness in Monitor Reporting*, 136 HARV. L. REV. 757 (2023). These Monitors may be referred to by other names, such as "independent private sector inspectors general" or "external compliance officers." Note that Root Martinez does not define monitors as "gatekeepers," reasoning that they play an ex-post role, after rule violations have occurred (the gate was already open, and the horses left the barn). *Id*. at 769. We use a broader definition of gatekeepers. And in our mind, ex post compliance advisors affect the ex-ante incentives to break the law (if you know that your ex-post monitor will be lax, you are more likely to break the law ex ante).

[37] Jennifer Arlen, *Prosecuting Beyond the Rule of Law: Corporate Mandates Imposed through Deferred Prosecution Agreements*, 8 J. LEGAL ANAL. 191, 201 (2016) (noting that many pretrial diversion agreements, such as non-prosecution (NPAs) and deferred prosecution (DPAs) agreements, mandate the appointment of outside monitors to "audit the firm to ensure its compliance with the duties imposed by the agreement").

appoint an *outside* compliance expert as their monitor, and companies that do not meet these expectations may be required to enter a guilty plea and suffer grave damages.[38]

Over the last couple of years outside compliance experts have also ventured into the ESG realm. In the past, ESG issues were treated as "nice-to-have" corporate philanthropy decisions, and so corporate insiders handled them internally.[39] Today, by contrast, some ESG issues have become a major source of financial and reputational risk for companies.[40] As a result, corporate insiders are increasingly compelled to reach out to outside experts for help on ESG.[41] The classic example here is "racial equity audits," whereby a company hires an independent third party to investigate its practices and policies regarding diversity and inclusion.[42] A related service is "forced labor audits," whereby an independent third party examines the company's production facilities and supply chains.[43] More generally, large institutional investors have started explicitly pressuring companies to use third-party audits to verify their ESG disclosure and behavior.[44]

B. Expectations for Compliance Gatekeepers are High

The previous Section examined how outside experts have been assuming more and more roles in corporate compliance. This Section shows just how much these roles matter. Corporate managers, investors, and regulators increasingly count on compliance gatekeepers to serve as a bulwark against corporate wrongdoing.

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[38] On the wide discretion that NPAs and DPAs accord prosecutors, and the ways in which prosecutors use this discretion to affect corporate behavior, *see also* Cindy R. Alexander & Mark A. Cohen, *The Evolution of Corporate Criminal Settlements: An Empirical Perspective on Non-Prosecution, and Plea Agreements*, 52 AM. CR. L. REV. 537, 555 (2015) (explaining the leverage that prosecutors enjoy vis-à-vis companies); Benjamin Greenblum, *What Happens to a Prosecution Deferred?*, 105 COLUM. L. REV. 1863, 1863 (2005) (detailing some of the grave consequences that companies may suffer).

[39] Roy Shapira, *Mission Critical ESG and the Scope of Director Oversight Duties*, 2022 COLUM. BUS. L. REV. 732, 724 (2022).

[40] *Id*.

[41] For a concise recent survey see Raquel Fox et al., *Skadden Discusses ESG in 2022 and Predictions for 2023*, CLS BLUE SKY BLOG (Feb. 10, 2023), https://clsbluesky.law.columbia.edu/2023/02/10/skadden-discusses-esg-in-2022-and-predictions-for-2023/ ("companies are increasingly seeking advice and consulting services to meet their ESG obligations and improve their ESG credentials").

[42] *See, e.g.*, Ron S. Berenblat & Elizabeth R. Gonzalez, *Racial Equity Audits: A New ESG Initiative*, HARV. L. SCH. F. CORP. GOV. (Oct. 30, 2021), https://corpgov.law.harvard.edu/2021/10/30/racial-equity-audits-a-new-esg-initiative/.

[43] *See, e.g.*, Amelia Pang, *The China Challenge: The Stain of Forced Labor on Nike Shoes*, DISCOURSE (Jan. 5, 2022) (using the example of Nike's factories to describe and criticize the practice).

[44] *See, e.g.*, David A. Bell & Ron C. Llewelyn, *Best Practices for Establishing ESG Disclosure Controls and Oversight*, HARV. L. SCH. F. CORP. GOV. (Feb. 3, 2022) https://corpgov.law.harvard.edu/2022/02/03/best-practices-for-establishing-esg-disclosure-controls-and-oversight/.

One indication of the level of expectations for compliance gatekeepers comes from looking at just how much companies are paying them. Roughly fifteen to twenty percent of the operating costs of companies (at least those in heavily regulated industries) are spent on governance, risk, and compliance.[45] And while companies do not volunteer pinpointed breakdowns of their compliance costs,[46] there exist ample indications that a not insignificant part of these hundreds of billions is going to outside experts. Indeed, the gatekeepers themselves indicate as much: company reports from major law firms and accounting firms reveal that compliance consulting has become the fastest growing revenue stream for them.[47] Another source of evidence is postmortem analyses of compliance failures, whereby the company is obliged to disclose how much it paid a given gatekeeper. To illustrate, when a pharmaceutical company was caught offering kickbacks to physicians, we learned that it paid an outside lawyer $52 million in fees to be an independent "monitor."[48] This is hardly an isolated example: compliance investigations concerning violations of FCPA, for example, typically involve a broad-scope, drawn-out time frame, and mountains of documents.[49] Accordingly, they may generate tens of thousands of billable hours.

When companies pay gatekeepers this much, it is plausible to assume that managers and shareholders expect gatekeepers to significantly reduce the legal and reputational sanctions that come with compliance failures.

Another indication of the high expectations for compliance gatekeepers is how regulators often nudge companies to hire them. To understand why regulators may prefer that companies hire outside experts, we need to go back to the origin story of the rise of corporate compliance.[50] Part of the raison d'etre of corporate compliance programs was to supplement public enforcement.[51] Government officials typically lacked the resources to make sure that all companies and their employees were complying with the law. Regulators therefore opted to provide companies with sticks and carrots

[45] William S. Laufer & Matthew Caulfield, *Wall Street and Progressivism*, 37 YALE J. REG. BULL. 36, 37 (2019).
[46] Veronica Root Martinez, *The Outsized Influence of the FCPA?*, 2019 U. ILL L. REV. 1205, 1223 (2019).
[47] Mihailis E. Diamantis, *Clockwork Corporations: A Character Theory of Corporate Punishment*, 103 IOWA L. REV. 507, 542 (2018); Jennifer M. Pacella, *The Regulation of Lawyers in Compliance*, 95 WASH. L. REV. 58, 947–953 (2020).
[48] Steven Davidoff Solomon, *In Corporate Monitor, a Well-Paying Job but Unknown Results*, N.Y. TIMES (Apr. 15, 2014) (accord Andrew Jennings, *The Market for Corporate Criminals*, 40 YALE J. REG. (forthcoming, 2023)).
[49] *See, e.g.*, Matteson Ellis, *Adding It Up: Why FCPA Investigations Are So Expensive*, FCPAMERICAS (Nov. 27, 2013), fcpamericas.com/english/anti-corruption-compliance/adding-up-fcpa-investigations-expensive/.
[50] *See generally* Fanto, *supra* note 27, at 191; Miriam H. Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 962–966 (2009); Griffith, *supra* note 1, at 2083-86.
[51] *Id*.

that incentivize investment in internal controls.[52] But over time, it became clear that internal controls too often amount to little more than cosmetic compliance.[53] That is, companies became adept at checking the right boxes to receive credit, without really curbing wrongdoing.[54] Regulators thus became wary of cosmetic compliance, and in response started demanding, explicitly or implicitly, that independent outside experts play a bigger role in compliance.[55]

These days, well-advised companies know that they must hire an *outside* law firm to conduct internal investigations, if they want to show government agents and prosecutors that the company is taking matters seriously, and thereby increase their chances of getting credit and a non-prosecution agreement.[56] Well-advised companies also know that they should commit to hiring an *outside* monitor to ensure that the company is in compliance with said non-prosecution or deferred prosecution agreements.[57] If the company fails to appoint an outside monitor, regulators may refuse to enter agreements with it.[58] This trend meshes well with Delaware courts' tendency to encourage corporate boards to make use of third-party advisors,[59] and with Sarbanes–Oxley's mandates that external auditors and in-house lawyers report up the ladder and to the regulator when they encounter material illegal actions.[60]

In all these regimes – from criminal law, to corporate law, to securities regulation – the system apparently counts on outside compliance gatekeepers to curb corporate wrongdoing. In other words, the effectiveness of all these regulatory enforcement strategies depends on outside compliance gatekeepers being effective at their jobs.

Yet another source of the high expectations for compliance gatekeepers is what the gatekeepers themselves promise to deliver. Indeed, a

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[52] *Id*.

[53] *See generally* Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487 (2003).

[54] *Id*.

[55] *See, e.g.*, Justin P. Murphy, Sarah E. Walters & Edward B. Diskant, *DOJ Revamps Corporate Criminal Enforcement Policies with Continued Emphasis on Compliance*, HARV. L. SCH. F. CORP. GOVERNANCE (Oct. 7. 2022) (reporting on the DOJ signaling its intentions to emphasize appointments of independent compliance monitors).

[56] Weisselberg & Li, *supra* note 11; Dan K. Webb & Steven F. Molo, *Some Practical Considerations in Developing Effective Compliance Programs: A Framework for Meeting the Requirements of the Sentencing Guidelines*, 71 WASH. U. L. Q. 375, 385 (1993).

[57] Arlen, *supra* note 37.

[58] *Id*. at 212.

[59] *Cf*. H. Justin Pace & Lawrence J. Trautman, *Mission Critical: Caremark, Blue Bell, and Director Responsibility for Cybersecurity Governance*, 2022 WIS. L. REV. 887, 944 (2022).

[60] 15 U.S.C. § 78j-1(b)(3) (2018). *See also* Standards of Professional Conduct for Attorney Appearing and Practicing before the Commission, 17 C.F.R. § 205 (2003); Susan P. Koniak, *When the Hurlyburly's Done: The Bar's Struggle with the SEC*, 103 COLUM. L. REV. 1236, 1236-39 (2003); William H. Simon, *Duties to Organizational Clients*, 29 GEO. J. LEGAL ETHICS 489, 501 (2016).

cursory look at compliance gatekeepers' websites and newsletters reveals promises (of, if you will, puffery) to dramatically reduce the legal and reputational risks that companies face.[61] For example, law firms' websites often highlight the presence of former senior regulators and enforcement professionals on the staff. They do so to imply, and sometimes to explicitly suggest, that having former regulators on staff will greatly help their clients meet current regulators' expectations, lend credibility to their internal investigations, and increase their chances of negotiating leniency.[62] Accounting firms' websites similarly promise to help clients reduce various risks and navigate through an increasingly complex regulatory environment.[63]

Granted, what gatekeepers say when they market their services is not necessarily what clients would expect when purchasing such services. Clients could very well discount these website statements as overinflated sales pitches. Still, it is worth noting the marked difference between how compliance gatekeepers market their services and how traditional gatekeepers market services such as auditing financial statements. With the latter, practitioners consistently try to narrow the "expectations gap," by dampening their clients' and the general public's expectations.[64] With the former, it seems that the gatekeepers proactively ramp up expectations, by touting their ability to improve corporate compliance for their clients.

C. Yet Compliance Gatekeepers are Rarely Accountable for Compliance Failures

When corporate debacles happen, regulators, academics, and the public often ask, "where were the gatekeepers?!"[65] In many instances this response is an unjustified knee-jerk reaction. After all, even the best, most publicly spirited outside compliance gatekeeper may fail to stop determined corporate insiders from engaging in shenanigans. Still, there exist other instances where outside gatekeepers could probably have done much more

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[61] *See, e.g.*, Kirkland & Ellis, *Government, Regulatory & Internal Investigations*, https://www.kirkland.com/services/practices/litigation/government-regulatory-internal-investigations.

[62] *See, e.g.*, DLA Piper, *Litigation, Arbitration and Investigations*, https://www.dlapiper.com/en/capabilities/practice-area/litigation-arbitration-and-investigations.

[63] *See, e.g.*, KPMG, *Manage Risk and Compliance*, https://kpmg.com/us/en/home/insights/2020/09/manage-risk-and-compliance.html; PwC, *The Risk Management Portfolio: Monitor, Identify, and Remediate Risk*, https://riskproducts.pwc.com/products.

[64] *See generally* Hian Chye Koh, *The Expectation Gap in Auditing*, 13 MANAGERIAL AUDITING JOURNAL 147 (1998).

[65] Donald C. Langevoort, *Where Were the Lawyers? A Behavioral Inquiry into Lawyers' Responsibility for Clients' Fraud*, 46 VAND. L REV. 75, 76 (1993) ("Where were the Lawyers?... this question is being asked all too frequently after large financial frauds"); *Cf.* Lincoln Say. & Loan Ass'n v. Wall, 743 F. Supp. 901, 920 (D.D.C. 1990); Laby, *supra* note 23, at 119.

and were not effective at their jobs. When would such failures amount to due-care violations or worse?

For "ex ante" compliance gatekeepers, being effective and taking due care means, for example, not mimicking what other companies are doing but rather customizing the design of reporting systems to the current needs of the company in question. For "ex post" compliance gatekeepers, being effective and taking due care means, for example, probing compliance hiccups diligently so that they do not deteriorate, and generating top-level individual accountability when large-scale compliance failures occur. We could also envision scenarios where gatekeeper failures were due to bad faith, such as knowing that company's agents are violating the law but turning a blind eye and not reporting upwards to the company's board (perhaps because the manager who hired them is the one committing the violations or benefitting from them).

Postmortem analyses and stylized facts from systematic empirical studies suggest that compliance gatekeepers not infrequently fail to exercise such due care. For "ex ante" compliance gatekeepers, there exist plenty of instances of gatekeepers being reactive instead of proactive, and mimicking common practices instead of tailoring reporting systems to relevant company-specific risks.[66] To illustrate, after a decade of explosive growth in FCPA enforcement,[67] compliance professionals apparently pushed companies to zero in on FCPA compliance, only to suffer significant compliance failures in other areas such as product safety or toxic emissions.[68] Todd Haugh summed it up as follows: "compliance today is surprisingly similar to that of twenty-five and even fifty years ago. While it is oft-repeated that there is no 'one-size-fits-all' compliance program, the reality is that most programs look very much alike – throughout individual companies and across all companies."[69] For "ex post" compliance gatekeepers, consider for example a study finding that only four percent of occupational fraud is discovered by outside auditors.[70] The researchers concluded that "auditors aren't necessarily looking for fraud and won't see what they aren't looking for."[71]

Granted, we do not have a foolproof "identification strategy" to pinpoint what compliance failures would have occurred regardless of the

[66] Miriam Hechler Baer, *Insuring Corporate Crime*, 83 IND. L. J. 1035, 1065 (2008) (on the problem of adhering to "common practices" as if they were "best practices"); Heaston, *supra* note 5, at 768 (same).
[67] Drury D. Stevenson & Nicholas J. Wagoner, *FCPA Sanctions: Too Big to Debar?*, 80 FORDHAM L. REV. 775, 784-85 (2011) (citing evidence on the increase in FCPA enforcement).
[68] Root Martinez, *supra* note 6, at 1220.
[69] Todd Haugh, *The Power Few of Corporate Compliance*, 53 GA. L. REV. 129, 146 (2018).
[70] Brian Fox, *Only 4% of Fraud Is Caught by Outside Auditors. It's Time for Accounting to Change Its Approach*, FORTUNE (Jul. 2, 2022).
[71] *Id*.

level of gatekeeper diligence. We suspect that no one has one, if only because researchers can only base their conclusions on public information, and information about who said what to whom inside a corporate compliance program is not public. But our point here is not to suggest that the current level of gatekeeper accountability is 62 while the optimal level of accountability is 85. Our point here is more modest, namely, that the current levels of gatekeeper accountability, which approach zero, are probably suboptimal given the influence that outside gatekeepers have on corporate compliance.

One way to illustrate our point is by looking at clear cases of compliance failures, which were litigated in courts and in the process produced an evidence trail showing what role compliance gatekeepers played. For concreteness, let us consider three of the most famous corporate law cases of failure-of-oversight claims in recent years: Blue Bell's food safety debacle, Boeing's flight safety debacle, and Victoria's Secret's sexual harassment debacle. The value of these cases for our argument is twofold. First, because plaintiffs were granted access to internal company documents, the cases provide a rare look behind the curtain of compliance failures. Second, because the corporate insiders – directors and top managers – were the focus of these lawsuits, the cases provide a juxtaposition between the ability to hold corporate insiders accountable and the ability to hold their outside advisors accountable.

Blue Bell, one of the largest ice-cream manufacturers in the U.S., suffered a listeria outbreak in its product lines, leading to several deaths and massive recalls.[72] Shareholders filed a derivative action, and their case resulted in the landmark *Marchand v. Barnhill* decision, which revamped corporate law courts' approach to *board*-level compliance.[73]

Prior to the 2019 *Marchand* decision, corporate law had remained remarkably silent on corporate compliance.[74] Directors' oversight duties (dubbed *Caremark* duties) were deemed "a toothless tiger."[75] Virtually all claims were dismissed at the pleading stage, since the plaintiffs could not provide "a smoking gun" showing that directors knew about a serious problem in real time (a "red flag") yet failed to act on it.[76] *Marchand* changed all this, by suggesting that the fact that there were no indications that Blue

[72] Marchand v. Barnhill, 212 A.3d 805, 807 (Del. 2019).
[73] Roy Shapira, *A New* Caremark *Era: Causes and Consequences*, 98 WASH. U. L. REV. 1857, 1858 (2021) (hereinafter, New Caremark Era).
[74] *Id*.
[75] Anne Tucker Nees, *Who's the Boss? Unmasking Oversight Liability within the Corporate Power Puzzle*, 35 DEL. J. CORP. L. 199, 216 (2010); Mercer Bullard, Caremark*'s Irrelevance*, 10 BERKELEY BUS. L.J. 15, 44 (2013); Charles M. Elson & Christopher J. Gyves, In re Caremark*: Good Intentions, Unintended Consequences*, 39 WAKE FOREST L. REV. 691, 692 (2004).
[76] For a thorough analysis *see* Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2032 (2019).

Bell directors had known about any food safety issue could, in itself, be an indication that directors breached their oversight duties.[77] If you are a director of a company that sells ice cream, and you have not discussed potential food safety issues for three years, you are probably not trying hard enough.[78] *Marchand* ushered in "a new *Caremark* era," typified by increased willingness to heighten the scrutiny of director oversight duties, and increased willingness to grant shareholders access to internal company documents in order to investigate potential failure-of-oversight claims.[79] As such, the decision has already been endlessly analyzed by corporate legal scholars and practitioners.[80]

Yet a key aspect of the Blue Bell case has hitherto remained ignored, namely, the role that outside compliance professionals played in the debacle. Prior to the listeria outbreak, Blue Bell management hired a third party to conduct audits of the company's sanitation issues.[81] The company's Vice President of Operations used to inform the board that the third-party audits went well, and the board was apparently satisfied and moved on without further probing.[82] When the sanitation issues then surfaced in the form of the listeria outbreak, the corporate insiders took the blame. But the outsiders who assured them that everything was fine did not.

While the Blue Bell debacle illustrates the unaccountability failure of ex ante compliance gatekeepers, the Boeing debacle illustrates the same for ex post compliance gatekeepers. When two MAX-737 airplanes crashed, killing hundreds of passengers, Boeing suffered attendant financial and reputational harms of well over twenty billion dollars.[83] Institutional shareholders filed a derivative action against Boeing's top management and directors for causing these harms by breaching their oversight duty.[84] The

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[77] Marchand v. Barnhill, at 824.
[78] *Id*. at 822 (designating food safety as "mission critical" for an ice-cream manufacturer).
[79] Shapira, New Caremark Era, *supra* note 73.
[80] *See, e.g.*, Robert C. Bird & Julie Manning Magid, *Operational Risk and the New Caremark Liability for Boards of Directors*, B.U. L. REV. (forthcoming), https://ssrn.com/abstract=4376029; Meghan Roll, *The Delaware Supreme Court Does Not Scream for Ice Cream: Director Oversight Liability Following Merchand v. Barnhill*, 57 SAN DIEGO L. REV. 809 (2020); Katherine M. King, *Marchand v. Barnhill's Impact on the Duty of Oversight: New Factors to Assess Directors' Liability for Breaching the Duty of Oversight*, 62 B.C. L. REV. 1925 (2021); Gregory A. Markel et al., *A Director's Duty of Oversight After Marchand in "Caremark" Case*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 23, 2022).
[81] Marchand v. Barnhill, at 812; Marchand v. Barnhill, 2018 WL 4657159, at *14 (Del. Ch. Sept. 27, 2018).
[82] *Id*.
[83] Chris Isidore, *Boeing's 737 Max Debacle Could Be the Most Expensive Corporate Blunder Ever*, CNN BUS. (Nov. 17, 2020), https://www.cnn.com/2020/11/17/business/boeing-737-max-groundingcost/index.html (detailing the direct costs resulting from the grounding of Boeing's fleet); Roy Shapira, *Max Oversight Duties: How* Boeing *Signifies a Shift in Corporate Law*, 48 J. CORP. L. 119, 124 (2022) (detailing the indirect costs) (hereinafter, Max Oversight Duties).
[84] *In re* Boeing Co. Derivative Litig., C.A. No. 2019-0907-MTZ, 2021 WL 4059934 (Del. Ch. Sep. 7, 2021).

court allowed the case to proceed and scolded Boeing's directors for failing to react swiftly and for not getting to the bottom of the airplane safety failures.[85] Popular media then followed the court decision with coverage that was voluminous in scope and unfavorable in tone toward the directors.[86] Boeing's directors and top managers were tarred and their reputation was damaged.[87]

Here as well, relatively little attention was given to the role that outside compliance professionals played in the debacle. To investigate the failures that led to the crashes, Boeing hired a well-respected outside law firm.[88] The law firm then produced an investigation report that mentions no official higher than a test pilot.[89] Yet it is unlikely that decisions to hide crucial information from the regulators and from the airline companies and pilots were made at the test-pilot level. Indeed, this is the implied conclusion behind the Delaware court's analysis in the case against Boeing's directors. The court scolded directors and was willing to let a *Caremark* claim (specifically, a failure to react to red flags) against them proceed, on the theory that the directors were not critical enough of top management and did not diligently probe the failures that led to the debacle.[90] Boeing's directors thus took the blame for letting top management off the hook too easily. Yet the outside gatekeepers who were paid handsomely to get to the bottom of things, and who let top managers off the hook, escaped such criticism.

Similar dynamics are at play also in ESG-related debacles. Consider for example one of the most covered instances of corporate sexual misconduct, namely, the L Brands (Victoria's Secret) case.[91] The fashion giant faced allegations concerning systematic sexual harassment by top executives, and the company founder's deep connections with Jeffrey Epstein (Epstein was apparently posing as a Victoria's Secret recruiter to prey on aspiring young girls).[92] When several L Brands shareholders filed requests to inspect the company's records and then filed failure-of-oversight lawsuits against the company's executives, the company quickly settled by

[85] *Id*.
[86] Shapira, Max Oversight Duties, *supra* note 83, at 133-135 (analyzing the content of media coverage).
[87] *Id*.
[88] John C. Coffee, Nosedive: Boeing and the Corruption of the Deferred Prosecution Agreement (working paper, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4105514.
[89] *Id*. at 13-16.
[90] *See, e.g.*, Boeing, at *16 n.50.
[91] Verified Stockholder Derivative Complaint, Lambrecht v. Wexner et al., No. 2021-0029-JTL (Del. Ch. Jan. 12, 2021); *see also* Stipulation and Agreement of Settlement, Rudi v. Wexner et al., No. 2:20-cv-3068 (S.D. Ohio Jul. 30, 2021). For an analysis of the case see Shapira, Mission Critical ESG, *supra* note 39.
[92] Shapira, *id.*

committing $90 million to prophylactic measures meant to root out its misogynistic culture.[93]

Yet here, too, the untold part of the story is the outside gatekeepers' part. After investigative reporters had exposed its sexual misconduct problems, L Brands retained another highly reputable law firm to conduct an internal investigation.[94] But the complaint against L Brands alleged that said law firm was conflicted and conducted a charade-like investigation, not even contacting many of the employees who were supposedly subjected to sexual misconduct.[95] The case was settled before any court discussion, and so we have less verified information on what went wrong leading up to the debacle. However, it is evident that the dynamics after the debacle were the same as in our previous examples: the spotlight was put on corporate insiders for failing to react to red flags and probe further, while the law firm that insiders hired to probe these red flags came out largely unscathed.

Postmortem analyses of failures by more traditional gatekeepers, such as accounting firms auditing financial statements, reveal some differences but ultimately similar-in-spirit dynamics.[96] When an accountant performs an audit of a firm's financial statement, the accountant must certify the effectiveness of the audited firm's internal controls. Accordingly, when major debacles such as Wells Fargo's phony-accounts scandal break, it is easy (sometimes too easy) for regulators and investors to point the finger at the financial auditor for not ferreting out wrongdoing. Yet even in this case, with its feet to the fire, the outside gatekeeper was able to escape accountability. Wells Fargo's CEO had to step down and millions of dollars of his incentive compensation were clawed back.[97] The chairman of the board was replaced, and the board committees were reshuffled.[98] Thousands of employees lost their jobs.[99] Yet Wells Fargo's outside auditor for eighty-five years, KPMG, remained in place and managed to shift responsibility to insiders.[100]

The overarching theme of these cases is twofold: (1) compliance gatekeepers apparently failed to flush out the problem earlier or investigate

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[93] Sierra Jackson, *L Brands Inks Deal with Shareholders to Exit Workplace Harassment Cases*, REUTERS (Jul. 30, 2021).
[94] Vivia Chen, *Whatever Happened to Davis Polk's Report on Victoria's Secret*, AM. LAWYER (Nov. 20, 2020), https://www.law.com/americanlawyer/2020/11/20/whatever-happened-to-davis-polks-report-on-victorias-secret/?slreturn=20230317131335.
[95] *Supra* note 91.
[96] Financial auditors provide services that are more akin to classic compliance gatekeeping than the services provided by other third-party financial advisors, such as i-bankers advising companies on deals. In that respect, examples of failures of financial auditors are constructive for our purposes.
[97] Francine McKenna, *Where Was KPMG, Wells Fargo's Auditor, While the Funny Business Was Going on?*, MARKET WATCH (Aug. 21, 2017).
[98] *Id*.
[99] *Id*.
[100] *Id*.

properly after the fact, and (2) they escaped accountability for it. Blue Bell's directors were dragged through the mud and paid a $60 million settlement, yet the auditors who told them that everything was fine emerged unscathed. L Brands' top executives were fired and received extensive negative media coverage, and the company spent $90 million addressing these executives' doings, yet the investigators who did not hold the executives accountable in real time were not named or shamed.

To clarify, we do not claim that the outside gatekeepers in these cases committed professional malpractice or acted in bad faith. We do not have enough information to make such legal determinations. Nor do we claim that in general gatekeeper misconduct is rampant. We cannot measure the overall level of gatekeeper behavior and how far it is from the optimum. Our claim here is more modest, namely, that the current state of affairs, whereby virtually no compliance failure leads to compliance gatekeeper accountability, is undesirable. At minimum we would want to see litigation or regulatory investigations or media reporting or some other form of public scrutiny digging into the behavior of compliance gatekeepers after the fact. In other words, while we cannot pinpoint the exact level of optimal gatekeeper accountability, we can say that the current, close-to-zero level is probably suboptimal.

Why do compliance gatekeepers keep escaping accountability, even in the most egregious cases? Could it somehow be socially optimal? If not, what can be done about it? These are the questions to which we now turn.

II. WHY IS THERE LITTLE ACCOUNTABILITY IN COMPLIANCE GATEKEEPING?

Various reasons combine to make private ordering and law enforcement ineffective at holding compliance gatekeepers accountable. And because compliance gatekeepers do not face a significant threat of reputational fallouts or legal liability even when the corporate compliance programs that they are advising on fail miserably, gatekeepers can safely opt to acquiesce to their clients (at worst) or follow the easy path of mimicking common practices that are not necessarily best practices (at best).

Section A details the various doctrinal hurdles that combine to make litigation against compliance gatekeepers a losing proposition, regardless of the merits. Section B explains why private ordering is ineffective. Third-party reputational sanctions are inaccurate, due to information asymmetries. And second-party contractual sanctions are virtually nonexistent, due to perverse incentives. For both parties to the compliance gatekeeping transaction, maintaining an "expectations gap" is a feature rather than a bug. It allows the outside gatekeepers to keep a promising revenue stream growing, while

allowing corporate insiders to pay with shareholders' money for their own plausible deniability.

A. Litigation

Nowadays, a director whose company gets embroiled in a compliance failure faces a real threat of oversight duty litigation.[101] The same applies to other top insiders, such as the CEO, the Chief Financial Officer, the General Counsel, and the Chief Compliance officer.[102] Yet litigation against outside compliance gatekeepers in such instances is still rare.[103] The reason for this stark difference between insiders' and outsiders' exposure to litigation is a combination of perverse incentives and doctrinal hurdles.

On paper, corporate insiders who were harmed (personally and derivatively) from compliance failures can make the company sue its compliance gatekeepers, if they believe that the latter misbehaved. No one is better positioned to flush out damning information about gatekeepers' misconduct than the corporate insiders who worked closely with them. Yet in reality, insiders rarely litigate against compliance gatekeepers. We suspect that this has to do with a "chumminess" factor and a "mutual assured destruction" (MAD) factor.

The "chumminess" factor refers to the degree to which compliance gatekeepers are hired by and work closely with the general counsel or other top insiders.[104] The relationships and trust developed between the insiders and the outsiders over the years can be a positive in many circumstances, as they foster cooperation and candor.[105] Yet the same relationships and trust can turn into a negative by reducing the likelihood that each party will hold the other accountable for compliance failures. Insiders will hesitate to utilize all legal avenues at their disposal against outsiders.[106] And an outside counsel

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[101] Shapira, *supra* note 73; Yaron Nili, *Board Gatekeepers*, 72 EMORY L.J. 91 (2022).

[102] *See, e.g.*, *In re* McDonald's Corp. Stockholder Deriv. Litig., C.A. No. 2021-0324-JTL (Del. Ch. Jan. 25, 2023) (clarifying that executives are subject to oversight duties too); Amy Deen Westbrook, *Double Trouble, Collateral Shareholder Litigation Following Foreign Corrupt Practices Act Investigations*, 73 OHIO ST. L. J. 1217, 1228 (2012); Kevin LaCroix, *FCPA Follow-On Civil Actions: Frequently Filed, Less Frequently Successful*, D&O Diary (Jun. 18, 2017), https://www.dandodiary.com/2017/06/articles/foreign-corrupt-practices-act/fcpa-follow-civil-actions-frequently-filed-less-frequently-successful/.

[103] *Cf.* Laby, *supra* note 23, at 151.

[104] To illustrate, almost one-third of all CFOs in S&P 500 companies come from the same Big Five accounting firms that sell these companies compliance gatekeeping services. CRIST KOLDER VOLATILITY REPORT (2022), www.cristkolder.com/volatility-report.

[105] One could also claim that there is a degree of chumminess between today's "compliance elites" and the other side, namely, the regulators and prosecutors. Miriam Baer, *Compliance Elites*, 88 FORDHAM L. REV. 1599 (2020). In that account, the socialization of compliance experts may be an advantage.

[106] *See, e.g.*, COFFEE, *supra* note 20, at 156. A similar, well-documented phenomenon is that of "beholden directors," whereby the fact that a director was appointed by the current CEO dilutes the former's willingness to monitor the latter. *See, e.g.*, Karen Schnatterly et al., *The Effects of Board*

conducting an internal investigation will not be quick to point the finger at the general counsel who hired her and has been amicable with her for decades.[107] Indeed, empirical studies show that appointment-based connections decrease the likelihood of fraud detection.[108]

The "MAD" factor refers to the degree to which insiders fear that if they attack compliance gatekeepers in court, these gatekeepers will have enough ammunition to strike back and expose the insiders' failings for other market actors to see.[109] This MAD factor applies regardless of how chummy the insiders and outsiders are, as it is strictly a matter of protecting one's reputation by not airing dirty laundry in public. These dynamics apply more strongly to compliance gatekeepers than they do to traditional, transactional gatekeepers. To be sure, corporate insiders may be reluctant to litigate against transactional gatekeepers as well: going after a top accounting or law firm would be burning a bridge with an influential repeat player in the industry.[110] And suing one specific financial advisor could make all the other financial advisors think twice before engaging with the company going forward.[111] But when it comes to compliance gatekeepers, MAD dynamics operate on steroids, as these third-party advisors usually have access to the most delicate information on corporate misconduct and who knew what when about it.

Corporate insiders thus often lack the incentives to pursue litigation against compliance gatekeepers. Still, other actors in the corporate governance world, such as institutional investors or entrepreneurial plaintiff attorneys, do have the incentives to go after well-paid advisors who failed at their jobs.[112] The main problem with these external actors is not one of incentives but rather one of doctrine.

An amalgamation of doctrines sets the bar for lawsuits against compliance gatekeepers high, requiring that plaintiffs plead with particularity facts indicating scienter on the part of the gatekeepers. In other words, due-care violations are not enough: plaintiffs must show that the gatekeepers knowingly violated their duties. This is true across all potential claims – from securities law, to breach of contracts and professional malpractice, to aiding-and-abetting breaches of fiduciary duties in corporate law.

Expertise–Risk Misalignment and Subsequent Strategic Board Reconfiguration on Firm Performance, 42 STRAT. MGMT. J. 2162, 2172 (2021).

[107] Henning, *supra* note 7, at 38 n.28.

[108] Vikramaditya E. Khanna, Han Kim, & Yao Lu., *CEO Connectedness and Corporate Frauds*, 70 J. FIN. 1203 (2015).

[109] *See* Andrew F. Tuch, *M&A Advisor Misconduct: A Wrong without a Remedy*, 45 DEL. J. CORP. L. 177 (2021) (analyzing the different but related context of deal litigation).

[110] *Id*.

[111] *Id*.

[112] On the incentives of such "bounty hunters" and how they contribute to corporate governance *see generally* Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings*, 14 J. LEGAL ANAL. 17 (2021).

Consider securities law claims first. On paper, shareholders can file a securities class action in federal courts, on the theory that the gatekeeper failed to ferret out fraudulent financial disclosures. Yet a series of doctrinal and statutory changes has rendered this conduit ineffective.[113] The 1995 Private Securities Litigation Reform Act (PSLRA) has raised the pleading standard and stayed discovery until after the motion to dismiss is decided.[114] As a result, outside shareholders now face the tall task of pleading with particularity facts about how involved the gatekeepers were, without having access to internal company documents (no discovery).[115] The PSLRA has also replaced the "joint and several liability" principle with "proportionate liability." That way, even if outside shareholders somehow manage to survive the motion to dismiss and establish gatekeeper liability, the gatekeeper is liable only for the percentages of responsibility that the court assigns to it.[116] And unlike in the context of auditing financial disclosures, in our context compliance gatekeeping usually does not give rise to a direct cause of action in securities law.[117] As if that was not enough, private lawsuits for aiding and abetting a breach of securities law were eliminated,[118] leaving enforcement of such claims to the resource-constrained SEC Enforcement Division.[119]

Following all these changes, plaintiffs largely stopped naming secondary defendants in securities class actions.[120] Indeed, a recent empirical study shows that litigation against auditors for accounting violations has significantly shrunk, and not because these gatekeepers have suddenly become better at ferreting out wrongdoing.[121]

Next consider the possibility of the company suing its gatekeepers for breach of contract or professional malpractice. Here there exists an obscure-yet-powerful doctrinal hurdle dubbed "*in pari delicto*."[122] The expression comes from Latin and is a shorthand for *in pari delicto, potior est conditio*

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[113] COFFEE, *supra* note 20, at 215-16.
[114] 15 U.S.C. §§ 77z-l(b), 78u-4(b)(3)(B) (2012).
[115] COFFEE, *supra* note 20, at 154-155 (noting how insurmountable that challenge is). As if that was not enough, the courts make it even harder to draw inferences of scienter in cases against outside gatekeepers, by assuming that these actors have fewer incentives than insiders to be involved in fraudulent statements. Gideon Mark, *Accounting Fraud: Pleading Scienter of Auditors under the PSLRA*, 39 CONN. L. REV. 1097, 1210 (2007).
[116] Unless it can be shown that the gatekeeper knowingly committed the relevant violations. COFFEE, *supra* note 20, at 154.
[117] Under Rule 10b-5 (17 C.F.R. §§ 240.10b5 (2013)), traditional gatekeepers can be considered primary wrongdoers if they make a misstatement or omission with scienter.
[118] Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 185 (1994); COFFEE, *supra* note 20, at 215-16.
[119] Tuch, *infra* note 243, at 1642-43.
[120] COFFEE, *supra* note 20, at 61.
[121] Collin Honigsberg, Shivaram Rajgopal & Suraj Srinivasan, *The Changing Landscape of Auditors' Liability*, 63 J. L. & ECON. 367 (2020).
[122] Claims of professional malpractice are also subject to complications due to the Economic Loss Rule. RESTATEMENT THIRD, TORTS: LIABILITY FOR ECONOMIC HARM.

defendentis, which roughly translates to "when both parties are equally at fault, the defendant stands in a better position."[123] This practically means that a plaintiff cannot recover damages from another party, if the plaintiff's losses are at least substantially equally caused by his own misdeeds (that is, by activities the law forbade him to engage in).[124] To illustrate, when Bernie Madoff's bankruptcy trustee sought damages from several of Madoff's co-conspirators, the court barred the claims because a fraudulent debtor cannot sue third parties for harms caused by the debtor's own fraud.[125]

Corporate law courts have traditionally applied *in pari delicto* to summarily dismiss shareholders' derivative actions against outside gatekeepers.[126] The reasoning is that when a company violates the law, the knowledge of company insiders who were involved in the violations is imputed to the company. Accordingly, when the compliance failure at hand concerns clear illegalities, shareholders are barred from pursuing claims on behalf of the company against its outside compliance gatekeepers.

Applying *in pari delicto* to immunize compliance gatekeepers is both bad law and bad policy. It is bad law because the concept of imputing knowledge to the company was developed to protect innocent third parties who dealt with the company against wrongdoing by the company's agents. In other words, the original formulation barred companies from using the "I didn't know" defense against third parties who dealt with company agents. It is counterintuitive to apply the same concept to bar lawsuits against gatekeepers that the company hired precisely for the purpose of combatting wrongdoing by its agents.[127] *In pari delicto* was meant to deny the company a shield against innocent third parties who were wronged by its agents, and not to deny the company a sword against its own agents who wronged it.[128]

Applying *in pari delicto* to immunize compliance gatekeepers is also bad policy. Basic economic analysis suggests that the criteria for where to place the blame for compliance failures should be who has better ability and

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[123] A related concept in equity is that of unclean hands. McKennon v. Nashville Banner Publ'g. Co., 513 U.S. 352, 360 (1995). A close cousin is the *ex turpi causa* principle, according to which no action can arise out of an immoral act. *Ex turpi causa* applies when the plaintiff committed misconduct on her own, with the defendant playing no role. By contrast, *in pari delicto* applies when both the plaintiff and the defendant had some role in the misconduct, and the question is whether they are at equal fault or not. Unlike *ex turpi causa*, *in pari delicto* is not an absolute bar. Brian A. Blum, *Equity's Leaded Fleet in a Contest of Scoundrels: The Assertion of the in Pari Delicto Defense against a Lawbreaking Plaintiff and Innocent Successors*, 44 HOFSTRA L. REV. 781, 782-83 (2016).

[124] In re LJM2 CoInvestment, L.P., 866 A.2d 762, 775 (Del. Ch. 2004); Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co., 267 F.3d 340, 354 (3d Cir. 2001).

[125] Picard v. JPMorgan Chase & Co., No. 11-5044 (2d Cir. Jun. 20, 2013).

[126] Paula Schaefer, *In Pari Delicto Deconstructed: Dismantling the Doctrine That Protects the Business Entity's Lawyer from Malpractice Liability*, 90 ST. JOHN'S L. REV. 1003, 1006 (2016).

[127] Deborah A. DeMott, *Further Perspectives on Corporate Wrongdoing, In Pari Delicto, and Auditor Malpractice*, 69 WASH & LEE L. REV. 339, 342 (2012).

[128] Christopher M. Bruner, *Agency and the Ontology of the Corporation*, 69 WASH. & LEE L. REV. 355, 358 (2012).

incentives to curtail wrongdoing, and who would be most affected by being subject to liability.[129] Courts that have applied *in pari delicto* to shield gatekeepers have assumed that (1) outside gatekeepers already have reputational incentives not to be involved in their client's wrongdoing, and so subjecting them to legal liability is superfluous, and (2) the company's decision-makers are well positioned to ferret out wrongdoing inside their company.[130] Accordingly, placing the blame on outsiders is unlikely to produce much added incentives, whereas placing the blame on insiders is likely to incentivize them to work harder to reduce corporate wrongdoing, or so the argument goes.[131]

Upon closer inspection, these two assumptions rarely hold in the context of compliance gatekeeping. Section II.B.1 below will elaborate on assumption (1), explaining why reputational discipline is ineffective at deterring compliance gatekeepers. Here we focus on why assumption (2) is dubious as well. One cannot assume that public shareholders or independent directors are better positioned than compliance gatekeepers to curtail corporate wrongdoing. In fact, the entire value proposition of the fast-growing compliance consulting business is that the company's directors and shareholders cannot do this job on their own and need to pay outside gatekeepers handsomely to perform it.[132] Compliance gatekeepers in public companies are paid millions of dollars and spend hundreds of hours precisely on the issues that these lawsuits revolve around.[133] Immunizing gatekeepers through *in pari delicto* would not magically endow public shareholders or independent directors with the ability to effectively monitor misconduct within their large corporations.[134]

Regardless of what one thinks about the desirability of applying *in pari delicto* to our context, the reality is that it currently presents a hurdle for litigation against compliance gatekeepers. Still, *in pari delicto* is not an absolute bar but rather a relative one. It contains three built-in exceptions: the public-interest exception, the bad-faith exception, and the fiduciary

[129] Cenco Inc. v. Seidman & Seidman, 686 F.2d 449, 455-56 (7th Cir. 1982).
[130] *Id*.
[131] *Id*.
[132] Former Chief Justice Strine acknowledged as much in the AIG case, remarking that PwC received $213 million and spent numerous hours going over the books, with the implication being that AIG's independent directors, who hired PwC, should be able to rely on the well-paid gatekeeper to detect and report back to the board on critical problems. In re American Intern. Group, Inc., 965 A.2d 763, n. 246 (Del. Ch. 2009) ("*AIG I*").
[133] *Id*.
[134] *Id* ("I do not understand how immunizing the auditors employed to help the independent directors monitor will make either stockholders or independent directors better monitors. I really do not get that"); *see also* Kirschner v. KPMG LLP, 938 N.E.2d 941 (N.Y. 2010) (Judge Ciparick dissenting).

exception.[135] The public-interest exception applies when there is a strong policy reason not to shield the defendants, which trumps the policy rationale for the doctrine.[136] The supposed policy rationale for *in pari delicto* is twofold: deterring wrongdoing by not granting wrongdoers any legal relief, and protecting the judicial system from using its scarce resources to adjudicate disputes between wrongdoers.[137] As the previous paragraphs articulated, in the context of claims against compliance gatekeepers there exists a strong countervailing policy reason. However, courts thus far have refused to apply it, reasoning that the gatekeepers have strong reputational incentives to be diligent, and so litigation against them may be superfluous.[138] We disagree and will return to this topic when discussing policy implications in Part III below.

The bad-faith exception tells us that outside gatekeepers who acted in good faith, even if they were negligent, are shielded by *in pari delicto*, but gatekeepers who knowingly colluded with company insiders are not.[139] The problem with the bad-faith exception is not conceptual but rather practical: to meet it, plaintiffs must marshal evidence about what outside gatekeepers knew and when they knew it, already at the pleading stage and before they reach discovery. Plaintiffs who can realistically do so are corporate insiders who have access to all the communications with gatekeepers. Yet insiders usually do not want to flush out damning information about compliance gatekeepers. The only way for public shareholders to plead bad faith on the part of the gatekeepers is to get pre-filing discovery. This issue brings us into hardcore corporate law territory, and to the third exception, namely, the fiduciary exception.

In a derivative action on behalf of the corporation, a fiduciary who breached her duties toward the corporation cannot immunize herself via *in pari delicto*.[140] Allowing otherwise would undermine the entire premise behind derivative actions. Third-party advisors are normally not fiduciaries.[141] Yet the Delaware court's 2015 *Stewart* decision maintained that the fiduciary exception applies also to aiding-and-abetting breaches of

[135] Stewart v. Wilmington Tr. SP Servs., 112 A.3d 271, 303 (Del. Ch. 2015). To be precise, there is a fourth exception, namely, the adverse interest exception. A key tenet of imputation is that the principal is not presumed to have knowledge of an action by an agent that completely abandons the principal's interests. *Id*. at 303; Restatement (Third) of Agency § 5.04. We do not discuss this exception here as it is very narrow and largely irrelevant in our context. *See also* Am. Int'l Group, Inc., Consol. Derivative Litig., 976 A.2d 872, 891 (Del. Ch. 2009) (hereinafter AIG II).
[136] AIG II, at 888.
[137] AIG II, at 882.
[138] See the analysis and references in Section III.A *infra*.
[139] Stewart v. Wilmington Tr. SP Servs, at 304.
[140] *Id*. at 304; AIG II, at 889-95.
[141] Stewart v. Wilmington Tr. SP Servs, at 297-98.

fiduciary duties.[142] On paper, this suggests a path for public shareholders to hold compliance gatekeepers accountable, namely, by suing them for aiding-and-abetting breaches of *Caremark* duties on the part of the company's directors and officers.

But in reality, aiding-and-abetting claims in the *Caremark* context are virtually impossible to bring.[143] To understand why, let us go back to basics. A plaintiff bringing an aiding-and-abetting claim in corporate law must prove that (1) a fiduciary has breached her duty (the "predicate breach" prong of aiding and abetting), *and* (2) the non-fiduciary defendant knowingly participated in said breach (the "knowing participation" prong of aiding and abetting).[144] In our context of compliance failures, this two-pronged requirement translates into having to clear not one but two very high pleading hurdles.[145]

To meet the predicate breach prong in failure-of-oversight claims, showing negligence or even gross negligence on the part of the directors is not enough.[146] The standard in *Caremark* claims is rather bad faith.[147] Plaintiffs have to show either that the fiduciaries completely failed to install a compliance program that monitors and reports back information to them (a prong-one *Caremark* claim), or that the fiduciaries installed such a system yet utterly failed to respond to "red flags" that it generated (a prong-two *Caremark* claim).[148]

A prong-one *Caremark* claim and a claim of aiding and abetting by compliance advisors usually cannot coexist. The mere fact that the board hired compliance advisors is often indication enough that the board addressed

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[142] *Id*. at 319. We caution that the precise scope and technique of applying *in pari delicto* varies across states, and is a murky area of law. Official Comm. of Unsecured Creditors of Allegheny Health Educ. & Res. Found. v. PriceWaterhouseCoopers, 607 F.3d 346, 350 n.2 (3d Cir. 2010); NCP Litigation Trust v. KPMG LLP, 187 N.J. 353, 901 A.2d 871 (N.J. 2006); Bruner, *supra* note 128, at 356-57. We focus here mostly on Delaware law for considerations of scope and brevity, and because it represents the lingua franca of corporate law.

[143] Indeed, the courts themselves proclaimed each one of these claims – a *Caremark* claim for predicate breach and a knowing participation claim – to be "one of the most difficult" to sustain. *Caremark*, at 967 (on just how difficult a *Caremark* claim is); *RBC*, 129 A.3d at 865-66 (on just how difficult an aiding-and-abetting claim is); Binks v. DSL.net, Inc., 2010 WL 1713629, at *10 (Del. Ch. Aug. 18, 2009) (same).

[144] *See, e.g.*, Zimmerman v. Crothall, 62 A.3d 676, 711 (Del. Ch. 2013); Gotham P'rs, L.P. v. Hallwood Realty P'rs, L.P., 817 A.2d 160, 172 (Del. 2002).

[145] We emphasize "*pleading* hurdles" to convey how plaintiffs must marshal evidence of the two prongs already at the pleading stage and before discovery. Kihm v. Mott, 2021 Del. Ch. LEXIS 191, *60 ("an aiding and abetting claim may be summarily dismissed based upon the failure of the breach of fiduciary duty claims against the director defendants. Lacking a well-pled predicate breach of fiduciary duty, the Complaint does not state a claim for aiding and abetting").

[146] Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006).

[147] *Id*.

[148] *Id*.

compliance.[149] Accordingly, the aiding-and-abetting claim would probably fall already at the predicate breach stage.

A prong-two *Caremark* claim (a failure to respond to red flags claim) and an aiding-and-abetting claim can theoretically coexist. For example, plaintiffs could claim that the outside compliance advisors colluded with top management and withheld critical information from the board, which in turn led to a failure to respond to red flags on the part of the board. Enron is a case in point. Red flags of financial frauds and embezzlements started appearing several years before Enron's collapse.[150] Yet whenever someone raised the flag internally, senior management turned the information over to its external auditor, Arthur Andersen, who then "whitewashed" the investigation and made sure that it never got to the audit committee.[151] Similarly, Enron's outside counsel, Vinson & Elkins, watered down the investigations of tips coming from whistleblowers.[152] The outside gatekeepers thus gave the board only information that senior management wanted them to give the board.[153]

The problem with litigation an aiding-and-abetting a red-flags claim is the mismatch between the high evidentiary bar and the lack of tools to clear it. Plaintiffs will have to plead facts supporting an inference of scienter not just on the part of the directors but also on the part of the outside advisors (the "knowing participation" prong).[154] A plaintiff will thus have to marshal evidence about what directors knew in real time, what outside advisors knew in real time, what outside advisors knew that the directors know in real time, what dialogue and discussion took place between insiders and outsiders, and so on. And she will have to marshal such evidence already at the pleading stage, and without access to discovery. What are her odds of doing that?

Here there is an important distinction between showing bad faith on the part of insiders and showing bad faith on the part of outsiders. The first hurdle remains high, but it has become relatively easier to clear in recent years, following *Marchand* and *Boeing*.[155] There is a new era in director oversight duty litigation, which manifests in two changes.[156]

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[149] Marchand v. Barnhill, 212 A.3d 805, 823 (noting that when the plaintiff conceded the board's use of third-party monitors, auditors, and consultants, her *Caremark* claim would likely be dismissed); Stewart, at 300 (rejecting a prong-one *Caremark* claim because the board hired third-party advisors to provide monitoring). In the context of deal litigation *see also* San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc., 983 A.2d 304, 318 (Del. Ch. 2009)) (hard to argue that directors who retained financial advisors acted in bad faith).

[150] COFFEE, *supra* note 20, at 26.

[151] *Id*.

[152] *Id*. at 32.

[153] *Id*. at 26.

[154] *In re* Columbia Pipeline Grp., Inc., 2021 Del. Ch. LEXIS 39, *145-147.

[155] Shapira, Max Oversight Duties, *supra* note 83, at 121.

[156] *Id*.

First, courts these days are more willing to apply heightened scrutiny to directors' compliance efforts.[157] When the compliance failure in question concerns "mission critical" compliance risks, courts are more likely to view absence of proof that the board discussed the issue as a pleading-stage indication that the board breached its duties.[158] Second, courts are also more willing to grant shareholders access to internal company documents to investigate potential failure-of-oversight claims against the board.[159] Shareholders have always enjoyed a qualified right to inspect their company's books and records, nestled in DGCL §220.[160] But in recent years, courts have liberalized their interpretation of Section 220's requirements,[161] so that they now order provision of internal documents in more cases,[162] and order the provision of a broader scope of documents (not just formal board materials, but also informal electronic communications).[163] In *Boeing*, for example, plaintiffs had access to 660,000 pages of internal company documents.[164] When sophisticated plaintiff attorneys gain such access, they are much more likely to find smoking-gun inferences regarding what the insiders knew and when they knew it. Advancing a *Caremark* claim against compliance insiders has therefore become relatively easier.

But advancing an aiding-and-abetting claim against compliance outside advisors has not similarly become easier. There have not been equivalent court decisions suggesting that courts will be willing to heighten the standard and sanction willful blindness on the part of outside gatekeepers. Nor have there been decisions suggesting that courts will be willing to grant liberal access to internal documents to investigate potential gatekeeper failures. The last point bears elaborating as it has thus far escaped the corporate law literature.

Delaware corporate law has experienced a marked increase in Section 220 actions and inspections in recent years.[165] A combination of a more

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[157] *Id*.
[158] Marchand, at 821.
[159] *Id*.
[160] DEL. CODE ANN. tit. 8, § 220 (2021).
[161] Roy Shapira, *Corporate Law, Retooled: How Books and Records Revamped Judicial Oversight*, 42 CARDOZO L. REV. 1949, 1952 (2021); Geeyoung Min & Alexander M. Krischik, *Realigning Stockholder Inspection Rights*, 27 STAN. J. L. BUS. FIN. 225, 233 (2022).
[162] *See, e.g.*, AmerisourceBergen Corp. v. Lebanon Cnty. Emps' Fund, 243 A.3d 417, 427 (Del. 2020) (clarifying that to demonstrate a "proper purpose" for inspection, shareholders do not need to show indications of an actionable claim against the directors).
[163] *See, e.g.*, *In re* Facebook, Inc. Section 220 Litig., No. 2018-0661-JRS, 2019 WL 2320842, at *18 n.185 (Del. Ch. May 30, 2019) (ordering Facebook's top executives and directors to produce not just formal board materials, but also private emails).
[164] *In re* Boeing Co. Derivative Litig., 2021 WL 4059934, at fn. 1.
[165] *See, e.g.*, James D. Cox, Kenneth J. Martin & Randall S. Thomas, *The Paradox of Delaware's 'Tools at Hand' Doctrine: An Empirical Investigation*, 75 BUS. LAW. 2123 (2020) (providing empirical evidence); George S. Geis, *Information Litigation in Corporate Law*, 71 ALA. L. REV. 407 (2019)

liberal approach by the courts and a more successful ascent of the learning curve by plaintiff attorneys has led to more frequent and more effective utilization of this important pre-filing discovery tool. The rise of Section 220 actions has reshaped the landscape of deal litigation and oversight-duty litigation.[166] But it has not extended thus far to aiding-and-abetting claims. The pertinent rulings on shareholders' right to information about potential gatekeeper wrongdoing predate the rise of Section 220.

In the 2001 *Saito v. McKesson* case, shareholders sought access to internal company documents to investigate potential wrongdoing on the part of the company's directors and their financial advisor, JPMorgan.[167] Then-Chancellor Chandler noted that examining the conduct of third-party advisors "with the ultimate view of filing separate actions" against them does not meet Section 220's "proper purpose" requirement.[168] On appeal, Delaware's Supreme Court clarified that the source of documents in the company's possession should not matter for shareholders' right to inspect it.[169] However, the Supreme Court did not interfere with the Chancellor's determination that pursuing claims against the third-party advisors is not proper purpose.[170] The issue came up again in the 2015 *SEPTA v. AbbVie* case, which also involved aiding-and-abetting claims against JPMorgan in the context of deal negotiations.[171] Vice Chancellor Glasscock saw no reason to depart from *Saito*. He ruled that inspecting documents for the purpose of investigating potential wrongdoing by third-party advisors en route to filing a lawsuit against them is not proper purpose.[172]

In our view, such an approach does not as a matter of law, and ought not as a matter of policy, apply to attempts to investigate aiding and abetting by compliance gatekeepers. There are several ways in which *Saito* and *AbbVie* are distinguishable from our context. For example, in *AbbVie* the alleged predicate breach on the part of the directors was of the duty of care. Directors took a risk, and it blew up in their company's face.[173] These are the kinds of decisions that are usually protected by the business judgment rule, and besides, AbbVie's directors were exculpated by a section 102(7)

(providing an early account); Min & Krischik, *supra* note 161 (providing a recent comprehensive account).

[166] Shapira, Corporate Law Retooled, *supra* note 161 (analyzing the Section 220 turn in deal litigation); Shapira, New Caremark Era, *supra* note 73 (analyzing the Section 220 turn in oversight-duty litigation).

[167] Saito v. McKesson HBOC, Inc., 2001 Del. Ch. LEXIS 96.

[168] *Id*. at *16-17 (noting in addition that "plaintiff has offered no affirmative authority that would sanction the use of a § 220 action against a company to attempt to develop a separate and distinct cause of action against financial advisors to that company during a transaction").

[169] Saito v. McKesson HBOC, Inc., 806 A.2d 113, 118, 2002 Del. LEXIS 379, *12-13.

[170] *Id*.

[171] SEPTA v. AbbVie Inc., 2015 Del. Ch. LEXIS 110, 2015 WL 1753033.

[172] *Id*. at *61-63.

[173] *Id*. at *3.

provision in the company's charter.[174] VC Glasscock thus saw no credible basis to imply actionable wrongdoing.[175] And the fact that directors faced no realistic liability threat was supposedly relevant to the question of whether to allow investigating the third-party advisor's conduct, because of the procedural stance.[176] VC Glasscock saw no reason to let shareholders inspect wrongdoing on the part of the third-party advisor, on the theory that it would ultimately be the board that would decide whether to pursue a claim against said advisors, and not shareholders.[177]

Our context is different from *Saito* and *AbbVie* both in terms of the underlying facts and in terms of the applicable law. In compliance failures the alleged predicate breach on the part of corporate insiders is the non-exculpated duty of loyalty.[178] Accordingly, as long as there is a credible basis for foul play on the part of the directors, there *is* actionable wrongdoing.[179] More importantly, a showing of actionable wrongdoing is no longer needed in Section 220 actions.[180] In 2020, Delaware's Supreme Court clarified that credible suspicions of wrongdoing at the company level are a proper purpose for inspection, regardless of whether shareholders have a readymade avenue to pursue legal action.[181] After all, shareholders may want to investigate potential wrongdoing also for non-litigation purposes, such as voting down directors or not rehiring auditors.[182]

There is therefore no good doctrinal reason to block public shareholders from accessing information that could help investigate the

[174] Under the "business judgment rule," courts give deference to disinterested, informed board decisions. *See generally* Stephen Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004).
[175] SEPTA v. AbbVIe, at *3.
[176] *Id*. at *62.
[177] *Id*. Derivative actions usurp the board's usual authority to decide on company matters. Shareholders who wish to file a derivative action on behalf of the company therefore effectively need to convince the court that making a demand on the board to assert the company's claims is futile. In many instances, the only way to do that is by showing that the majority of the board faces a substantial likelihood of personal liability for the behavior in question. But if, as was the case in AbbVie, directors face no liability threat, their judgment on whether to pursue a case against third-party advisors on that matter is not tainted, and so demand is not futile. United Food & Com. Workers Union & Participating Food Indus. Empls. Tri-State Pension Fund v. Zuckerberg, 250 A.3d 862 (Del. Ch. 2020), aff'd at 2021 WL 4344361; Rales v. Blasband, 634 A.2d 927, 930 (Del. 1993).
[178] Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006) (clarifying that a *Caremark* breach is a breach of the duty of loyalty).
[179] Amalgamated Bank v. Yahoo! Inc., 132 A.3d 752, 786, 2016 Del. Ch. LEXIS 64, *67-68 (distinguishing AbbVie on that basis); Okla. Firefighters Pension & Ret. Sys. v. Citigroup Inc., 2015 Del. Ch. LEXIS 119, *16, 2015 WL 1884453 (same).
[180] "No longer needed" assumes that it was once needed. In fact, some may think that it was never needed, and that AbbVie was a mistake of law in that regard. Leb. Cty. Employees' Ret. Fund v. Amerisourcebergen Corp., 2020 Del. Ch. LEXIS 17, *35-36, 2020 WL 132752.
[181] AmerisourceBergen Corp. v. Leb. Cnty. Emps.' Ret. Fund, 243 A.3d 417 (Del. 2020).
[182] Leb. Cty. Employees' Ret. Fund v. Amerisourcebergen Corp., at *35-36.

causes of their company's compliance failures.[183] But even if a future court will accept our premise and grant inspection rights to investigate potential gatekeeper misconduct, plaintiffs will still face an uphill battle proving "knowing participation." To prove the *knowing* participation of compliance gatekeepers in a predicate breach, plaintiffs may have to overcome issues of attorney-client privilege.[184] In other words, even if courts determine that investigating gatekeeper misconduct is proper purpose for Section 220 requests, they may limit the permissible scope of documents to inspect.[185] And to prove *participation*, it is not enough to show that gatekeepers were somewhat involved in information not flowing to the board; plaintiffs rather must show that the advisor *substantially* assisted the violator.[186]

The costs of sustaining an aiding-and-abetting claim against compliance gatekeepers are therefore very high for entrepreneurial plaintiff lawyers. And the gains from sustaining such claims may be limited. Contrast our context with the context of third-party financial advisors in deal litigation. There, going after the third-party financial advisors may make sense, since the directors may be exculpated or protected by the business judgment rule.[187] In other words, there will be cases in deal litigation where the third-party advisors are the only viable pocket for plaintiff lawyers to get a remedy from. In our context of failure-of-oversight litigation, by contrast, the directors are not exculpated. If the plaintiff lawyer files a Section 220, and somehow manages to find indications of bad faith on the part of the directors, she stands to gain considerably. Once the defendants lose on the motion to dismiss, they are likely to be eager to settle before the case reaches discovery, if only because they are wary of any findings that could take away their D&O policy coverage. In such cases, the plaintiff lawyer has already won, and there is no reason for her to fight another, lengthier and much costlier battle to flush out gatekeeper misconduct.

Indeed, aiding-and-abetting claims against third-party *financial* advisors in *deal* litigation have become relatively more prevalent in recent

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[183] To clarify: the right to inspect your company's books and records does not extend to the external advisor's books and records. The issue here revolves around access to the communications between the company and the outside advisor, which are in the company's possession.

[184] Upjohn Co. v. United States, 449 U.S. 383, 390 (1981). Granted, Delaware's corporate law recognizes the "Garner" exception in fiduciary duty litigation. Garner v. Wolfinbarger 430 F. 2d 1093 (5th Cir. 1970). Yet the exception is "narrow, exacting, and intended to be very difficult to satisfy." Wal-Mart v. IBEW, 95 A.3d 1264, 1278 (Del. 2014).

[185] On the "permissible scope" prong see Saito v. McKesson HBOC, Inc., 806 A.2d 113, 116 (Del. 2002).

[186] *In re* Dole Food Co., Inc. S'holder Litig., 2015 WL 5052214, at *41 (Del. Ch. Aug. 15, 2015).

[187] When negotiating transformational deals, directors may be under "*Revlon* duties," meaning that conduct will be assessed for reasonableness. That way, even if the directors are exculpated and do not face liability, the court may infer that their conduct fell outside the range of reasonableness, which in turn establishes the "predicate breach" prong of an aiding-and-abetting claim against the board's financial advisors. RBC, at *66.

years.[188] But the circumstances there differ from those of claims against third-party compliance advisors in oversight-duties litigation in the following three important ways. First, plaintiffs in deal litigation historically enjoyed better access to discovery: either through expedited discovery, or through discovery in preceding appraisal litigation, or through better chances of reaching full discovery due to the "enhanced scrutiny" pleading standard. Once they reached discovery, plaintiffs could amend their complaint to assert newfound aiding-and-abetting claims against the company's financial advisor.[189] In *Caremark* litigation, as just noted, such staggered discovery stages and complaint amendments are less likely: either the case is quickly dismissed, or it is quickly settled. Second, courts in deal litigation cases have more reasons to make inferences against the third-party advisors. After all, financial consultants in transformational deals usually have a clear and present personal stake.[190] They are commonly "retained on terms that contemplate a large contingent fee if the corporation is sold," and commonly have "substantial, ongoing business relationships with various prospective buyers." In *TIBCO*, for example, Goldman Sachs' had a $47 million contingent fee hinging on the deal going through. It is hard to envision a similar scenario with compliance consultants. Finally, courts in deal litigation have a more readymade doctrinal hook to establish predicate breach, namely, *Revlon* duties. When directors operate in *Revlon* land, their conduct is being assessed for reasonableness.[191] The same cannot be said for oversight duty litigation: while it can be argued that *Marchand* and *Boeing* somewhat heightened the scrutiny of board oversight of mission critical risks, Chancellor McCormick clarified that they have not reached *Revlon's* reasonableness standard.[192]

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In January 2023, Delaware's *McDonald's* decision explicitly stated that duty-of-oversight claims can be asserted not just against directors but also against officers.[193] On paper, such a decision may lead to an increase in

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[188] Martin Lipton, *The Delaware Courts and the Investment Banks*, HARV. L. SCH. F. CORP. GOV. (Oct. 30, 2015), https://corpgov.law.harvard.edu/2015/10/30/the-delaware-courts-and-the-investment-banks/.

[189] *See, e.g.*, Joel E. Friedlander, *Confronting the Problem of Fraud on the Board*, 75 BUS. LAWYER 1441, 1464 (2020) (on how discovery in the *Good Technology* case unearthed claims against the financial advisor) (*in re* Good Tech. Corp. S'holder Litig., C.A. No. 11580, 2017 WL 2537347 (Del. Ch. May 12, 2017)); Joel Friedlander, *Vindicating the Duty of Loyalty*, 72 BUS. LAWYER 623, 642 (2017) (on the full merits discovery in the *RBC* case unearthed claims against the financial advisor).

[190] Friedlander, *id*. at 1482.

[191] *Id*. at 1477.

[192] City of Detroit Police & Fire Ret. Sys. v. Hamrock, C.A. No. 2021-0370-KSJM, 2022 WL 2387653, at *14 n.111 (Del. Ch. Jun. 30, 2022); Shapira, Mission Critical ESG, *supra* note 39, at 747 n.46.

[193] *In re* McDonald's Corp. Stockholder Deriv. Litig., C.A. No. 2021-0324-JTL (Del. Ch. Jan. 25, 2023). *See also* Gantler v. Stephens, 965 A.2d 695, 709 (Del. 2009) (recognizing that in general "the fiduciary duties of officers are the same as those of directors.").

compliance gatekeepers' accountability going forward. The reason is that third-party compliance advisors usually work directly with top officers, such as General Counsels, or Chief Compliance Officers, or Chief Financial Officers. Accordingly, if institutional shareholders and their attorneys will start submitting requests to inspect their company's books in order to investigate potential failure-of-oversight on the part of these top insiders, they will be bound to come across work products of third-party compliance advisors. And if the courts will grant access not just to formal work products but also to electronic communications between top officers and their compliance advisors, plaintiffs will be bound to get a pick into what the gatekeepers knew, when they knew it, and what they (did not) do to stop problems.[194] In other words, the prospect of finding indications of aiding-and-abetting breaches of *officer* oversight duties is more likely to succeed than the prospect of finding indications of aiding-and-abetting breaches of director oversight duties.

But in this context as well, there exists a doctrinal hurdle that lowers the likelihood of sustaining a claim against the third-party advisors, namely, demand futility. Shareholders who wish to file a derivative action on behalf of the company effectively need to convince the court that making a demand on the board to assert the company's claims is futile.[195] If the predicate breach is one of *officers'* oversight duties, and the directors do not face a substantial likelihood of personal liability, demand may not be considered futile. Entrepreneurial plaintiff attorneys may therefore anticipate that claims against officers are likely to be dismissed at the pleading stage under Rule 23.1.[196] As a result, plaintiff attorneys may be less likely to invest in probing officers' failure-of-oversight to begin with, thereby lowering the chances of holding the officers' *advisors* accountable.

In sum, the odds are stacked against the prospect of litigation involving compliance gatekeepers.

But is this necessarily a bad thing? One could claim that third-party compliance advisors fulfill a role that is "primarily contractual in nature, is typically negotiated between sophisticated parties, and can vary based upon a myriad of factors."[197] Accordingly, the task of rectifying gatekeeper

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[194] *Cf.* Friedlander, *supra* note 189, at 1472 (noting in the context of deal litigation that gaining access to electronic discovery is the only way to prove misbehavior on the part of the financial advisors, showing that the latter held out critical information from the board).

[195] *Supra* note 177.

[196] Indeed, that was the ultimate result of the abovementioned *McDonalds* case. *See also* Ann Lipton, *Much Ado about Nothing*, BUS. L. PROF. BLOG (Mar. 4, 2023), https://lawprofessors.typepad.com/business_law/2023/03/much-ado-about-nothing.html.

[197] *Cf.* RBC, at n.191 (noting that financial advisors should not be considered "gatekeepers"). We note that our context of compliance advisors is different, given that companies, investors, and regulators often expect from them to deter wrongdoing.

misbehavior could and should be left for corporate boards.[198] Boards could determine what services and on what terms to pay for, and who to hire. In other words, one could claim that the best way to achieve gatekeeper accountability is not through litigation but rather through private ordering.[199] We turn to this private-ordering claim next.

B. Private Ordering

Even without a realistic threat of legal sanctions, compliance gatekeepers may be incentivized to be diligent due to the threat of nonlegal sanctions. Gatekeepers may fear retaliation by their contractual partners, who may not rehire them or may exercise contractual remedies such as clawing back paid fees. Gatekeepers may also fear loss of future business opportunities from third-party observers, who may view compliance failures in one company as an indication of the low quality of gatekeepers. But market discipline of this ilk – whether through second-party sanctions or through third-party sanctions – is often ineffective in our context, due to extreme information asymmetries and perverse incentives.

1. Third-Party Sanctions

Courts that apply *in pari delicto* to let gatekeepers off the hook tend to rely on the "reputational concerns" rationale.[200] According to the argument, outside law firms and accounting firms already have strong reputational incentives to do a good job in ensuring that their clients do not run afoul of the law.[201] As a result, there is no public policy consideration strong enough to exempt claims against the gatekeepers from the *in pari delicto* principle.[202] In other words, compliance gatekeepers are incentivized to perform well, because if they fail at their job, they will have a hard time securing future business opportunities. These gatekeepers simply have too much reputation at stake to acquiesce to a single client.[203] The costs of a reputational fallout following a compliance debacle in one company far outweigh the benefits of keeping said company as a client, or so the argument goes.

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[198] *Cf.* William W. Bratton & Michael L. Wachter, *Bankers and Chancellors*, 93 TEX. L. REV. 1, 64–65 (2014) (in the context of third-party financial advisors).
[199] Lipton, *supra* note 188.
[200] *See, e.g.*, Kirschner, *supra* note 134; Blum, *supra* note 123 (collecting references).
[201] *See, e.g.*, Amanda M. Rose, *The Multi-Enforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2182 n.26 (2010).
[202] Kirschner, *supra* note 134.
[203] DiLeo v. Ernst & Young, 901 F.2d 624, 629 (7th Cir. 1990).

But whether reputation concerns are enough to incentivize proper gatekeeper behavior is an empirical question, which has not been systematically examined to date. We are unaware of evidence that past compliance failures are associated with a reduction in future gatekeeping business opportunities. In fact, we are aware of numerous examples of the opposite, namely, compliance gatekeepers keeping their lucrative positions even in the wake of gross compliance debacles.[204]

A close inspection of the market for compliance consulting reveals several flaws that soften the force of reputational discipline. The literature on traditional gatekeepers emphasizes market concentration as a barrier to reputational discipline.[205] The idea is intuitive: when there are few sellers in a certain market, the ability of buyers to discipline sellers by switching to competitors is limited.[206] But this market-power argument applies less forcefully in the market for compliance gatekeeping, which is largely competitive. The barrier to reputational discipline that is most relevant in our context is basic information problems.

For compliance gatekeepers to suffer reputational fallout following failures, several conditions must hold, namely, revelation, diffusion, certification, and attribution.[207] Damning information about how gatekeepers behaved must surface (revelation). Yet in most cases only corporate insiders could have access to such information, and they are reluctant to flush it out, due to the "chumminess" and the "MAD" reasons detailed above. Even in the rare cases where damning information about compliance gatekeepers is

[204] The most famous examples come from external auditors who let large-scale fraud happened under their not-so-watchful eye. To illustrate, in 2014 JPMorgan paid $1.7 billion for failure to report suspicious transactions in connection to Bernie-Madoff's Ponzi scheme. JPMorgan's external auditor at the time, PwC, has emerged unscathed and continues serving as JPMorgan's auditor to this day. In fact, PwC has been holding the same position since 1965. Similarly, when Goldman Sachs was forced to pay $3.3 billion for an alleged FCPA violation, PwC kept is position as Goldman's external auditor. PwC has been holding the same position since 1922. *See* Press Release, U.S. Attorney's Office: *S. Dist. of N.Y., U.S. Dep't of Justice, Manhattan U.S. Attorney and FBI Assistant Director-in-Charge Announce Filing of Criminal Charges Against and Deferred Prosecution Agreement with JPMorgan Chase Bank, N.A., in Connection with Bernard L. Madoff's Multi-Billion Dollar Ponzi Scheme* (Jan. 7, 2014), https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-and-fbi-assistant-director-charge-announce-filing-criminal; Goldman Sachs Group, Inc., Annual Report 2022, Form 10-K, https://www.sec.gov/ix?doc=/Archives/edgar/data/886982/000119312522052682/d192225d10k.htm#toc192225_47, at 120. *See also* Francine McKenna, *What's Behind the SEC's Auditor Independence Warning? Auditors Don't Care About Reputation Risk Anymore*, THE DIG (Oct. 30, 2021) ("It's a myth that the largest global audit firms will avoid doing anything that harms their reputation, and will police their own").

[205] *See, e.g.*, James D. Cox, *The Oligopolistic Gatekeeper: The U.S. Accounting Profession*, *in* AFTER ENRON: IMPROVING CORPORATE LAW AND MODERNISING SECURITIES REGULATION IN EUROPE AND THE U.S. 269, 270-73 (John Armour & Joseph A. McCahery eds., 2006).

[206] Shapira, *supra* note 10.

[207] ROY SHAPIRA, LAW AND REPUTATION: HOW THE LEGAL SYSTEM SHAPES BEHAVIOR BY PRODUCING INFORMATION 21-23 (2020) (explaining how damning information translates into reputational sanctions).

revealed and widely disseminated (diffusion),[208] it still has to be perceived by outside observers as credible (certification). And it has to be interpreted by outside observers as indicative of the gatekeepers' behavior going forward. That is, outside observers have to attribute the compliance debacle to a systematic failure on the part of the gatekeeper, which is likely to resurface in the future (attribution).[209] Yet it is often hard for outside observers to ascertain who inside the company could have done more to prevent the compliance debacle.

The broader point here is that the market for compliance advice and internal investigation is fraught with information problems.[210] The service that compliance consultants sell is what economists call "a credence good," meaning that even those who purchase it cannot readily assess the quality of what they paid for. Market participants, when left to their own devices, will often fail to distinguish between high-quality gatekeepers and low-quality gatekeepers. Reputational concerns will not provide proper incentives in such a market unless the market gets a helping hand in the form of a source injecting quality new information on gatekeeper behavior. One potential source of such quality information is law enforcement actions, such as the discovery process in litigation or detailed regulatory investigation reports.[211] Indeed, in other areas of corporate behavior litigation is the most important source of media and reputational accountability.[212] Yet, as Section II.A explained, there is very little litigation against compliance gatekeeping.

2. Second-Party Sanctions

"This guy's going to testify, 'My accountant's a smart guy – I just relied on my accountant.' The accountant's going to say, 'I just relied on what he gave me,' and everyone has plausible deniability"[213] Preet Bhrara, former U.S. Attorney for S.D.N.Y.

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[208] In reality, information about past gatekeeper misconduct is not only unlikely to be revealed but even when it is revealed it is unlikely to be widely disseminated. Tuch, *supra* note 119, at 1614.

[209] SHAPIRA, *supra* note 207, at 22.

[210] Considerations of brevity and scope dictated that we not delve into the variation in reputational dynamics across each of the various compliance services that outside professionals provide. Still, we wish to highlight here one dynamic that is especially problematic: to the extent that regulators implicitly push companies to hire independent monitors as a condition for signing a non-prosecution agreement, the market for independent monitors' reputation could lose its effectiveness. As Frank Partnoy argued in the context of the market for traditional gatekeepers such as credit agencies, "regulatory licenses" crowd out incentives to invest in reputation for integrity. Once gatekeepers know that clients must hire them, they switch to competing over costs instead of competing over integrity. Frank Partnoy, *Barbarians at the Gatekeepers: A Proposal for a Modified Strict Liability Regime*, 79 WASH. U. L. Q. 491, 505 (2001).

[211] SHAPIRA, supra note 207, at 35-74.

[212] *Id* (providing evidence based on content analysis of media coverage).

[213] George Packer, *A Dirty Business*, THE NEW YORKER (Jun. 27, 2011), at 51.

Even if outsiders cannot hold compliance gatekeepers accountable via litigation or reputation, it is possible that the corporate insiders who hired the gatekeepers will. In fact, if there is indeed an expectations gap in compliance gatekeeping, one would think that it would be in the interests of both parties to the compliance gatekeeping contract – the corporate insiders and their outside consultants – to narrow the gap. If company X believes that gatekeeper Y overpromised and underdelivered, company X would presumably refrain from hiring gatekeeper Y going forward. Gatekeepers, being the repeat, sophisticated players that they are, will anticipate these dynamics and invest in the quality and integrity of their compliance services, or so the argument goes.[214]

The problem with this argument is that it ignores the incentives of the decision-makers on both sides of the equation. We cannot assume that all compliance gatekeepers strive to act diligently. In the nascent but fast-growing market for compliance gatekeeping, sellers focus on marketing additional services to an existing client pool. For example, a law firm that was hired to advise on occasional deals, or to represent in occasional litigation, may now wish to be hired to conduct internal investigations too. And an accounting firm that used to be hired to audit the financial statements may now wish to be hired to conduct "racial diversity audits." In such settings, compliance gatekeepers may wish to avoid developing a reputation for being diligent and rigid with their clients and opt to develop a reputation for being lenient with their clients instead.

To be precise, the issue here is two-sided reputation markets.[215] To the outside world, gatekeepers wish to maintain a reputation for being diligent. To the corporate managers that hire them, gatekeepers may wish to maintain a reputation for being lenient. In fact, it is in the interest of managers too that gatekeepers play the two-sided game. Insiders would want their outside compliance advisors to have a reputation for integrity, because such a reputation is what prompts prosecutors and investors to give the company credit when it hires an outside gatekeeper.

In other words, both parties to the compliance gatekeeping transaction have an interest in keeping up appearances. They want to present a certain picture to the outside world, which will not necessarily reflect the reality in

[214] An ex-ante version of that argument will point to the ability of corporate insiders to contract in advance for more gatekeeper accountability. Corporate insiders who believe that more accountability on the part of their outside compliance advisors is preferable could contract for it or at least refuse gatekeepers' common practice of including numerous qualifiers in their contracts. The fact that we rarely see insiders bargain in this way with outside compliance professionals is indication enough that the current low level of outsiders' accountability is optimal, or so the argument goes. Victor P. Goldberg, *Accountable Accountants: Is Third Party Liability Necessary?*, 17 J. LEGAL STUD. 295, 304-05 (1988).

[215] *See, e.g.*, Matthieu Bouvard & Raphael Levy, *Two-Sided Reputation in Certification Markets*, 64 MGMT. SCI. 4755, 4755 (2018).

which they live. Specifically, it is in the interest of both corporate insiders and their outside compliance gatekeepers that the latter *appear* rigid and demanding toward the former, while at the same time not actually being so.

The expectations gap may thus be a feature rather than a bug in the market for compliance gatekeeping.[216] The buyers – corporate insiders – do not necessarily want outside compliance gatekeepers to stop the company from making profits by skirting regulations in real time. Nor do corporate insiders want outside gatekeepers to probe their internal affairs diligently and place the blame for corporate wrongdoing at their feet. At the same time, top corporate managers are often fine with paying gatekeepers handsomely – out of the shareholders' pockets, that is – and are fine with expectations for the gatekeepers being high. That way, if a compliance debacle occurs, the general counsels and directors can shift the blame to the well-paid gatekeepers. From the sellers' (gatekeepers') perspective, it is convenient to ramp up expectations while not being stringent with clients, because this equilibrium keeps a newfound revenue stream alive and growing. This is especially true if the reputational sanctions that gatekeepers pay for compliance failures are limited. The equilibrium of high expectations and somber reality is therefore stable, as it seemingly favors all players with a direct interest in the game.

The corporate governance literature often invokes the metaphor of a chain of actors who do their job and are subject to legal and reputational liability if they do not: directors, managers, and outside gatekeepers.[217] However, compliance gatekeeping practice seemingly inverts this principle. It turns the chain of liability into a Möbius strip, or *an endless loop of plausible deniability*. Insiders can say that they relied on the advice given to them by well-reputed, highly paid outsiders, while outsiders can say that they relied on the information given to them by insiders.

The heavy reliance on outside compliance professionals creates a situation where the buck stops nowhere. The diffusion of knowledge and responsibility among insiders and outsiders further buttresses the cycle of plausible deniability.[218] Insiders define the problem to outsiders, who then frame the issue (that they only see in tunnel vision) to insiders.[219] When failures in compliance occur, the insiders rarely utilize legal avenues to hold outside gatekeepers accountable. Instead, corporate insiders protect their outside advisors' reputation, thereby staving off regulation and saving face in the court of public opinion.

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[216] Alternatively, one could say that calling it an "expectations gap" is a misnomer: both the service providers and their clients expect a lenient rather than diligent treatment.
[217] *Id*.
[218] Robert Eli Rosen, *Problem-Setting and Serving the Organizational Client: Legal Diagnosis and Professional Independence*, 56 U. MIAMI L. REV. 179 (2001).
[219] COFFEE, *supra* note 20, at 226.

The ones suffering from the existing equilibrium are dispersed publics: from outside shareholders who foot the bill for heavy fines, to community members who suffer from the effects of pollution, to users who have their privacy violated. Theoretically, we would expect institutional investors and regulators to intervene on behalf of these dispersed publics, and push corporate insiders and their outside advisors to deliver better compliance results. Yet institutional investors are seemingly not interested in being active on that front: they do not challenge gatekeepers in shareholder meetings or in courts.[220] And regulators cement the existing equilibrium when they react to publicized corporate debacles by ramping up regulatory requirements for internal controls.[221] Such regulatory responses only give insiders more reason to pay outside professionals and provide outside professionals with more business. A different type of regulatory response is badly needed. The next Part suggests a few possibilities.

III. HOW TO IMPROVE ACCOUNTABILITY

Our analysis thus far has emphasized an anomaly: outside compliance gatekeepers play an outsized role in corporate compliance, yet they are rarely held accountable for compliance failures. This Part examines ways to mitigate the apparent lack of accountability. Section A focuses on lessons for courts. Corporate law has traditionally remained silent on compliance failures, with many commentators considering director oversight duties as a toothless tiger.[222] In recent years Delaware courts have revamped director oversight duties, and recognized officer oversight duties. As a result, top corporate insiders now face a real legal and reputational threat when their company's compliance program fails. However, this move has not extended thus far to those whom the insiders rely on to fulfill their duties, namely, outside compliance gatekeepers. Section A explains what courts can do to remedy the situation. Section B then outlines broader implications for regulators, highlighting the need to rethink tools such as conditioning the credit given for cooperation and relying on self-regulation mechanisms. Section C sketches directions for future scholarly research.

A. Lessons for Courts

The main upshot of Section II.A above was that various doctrines combine to render the chances of litigation against compliance gatekeepers

[220] McKenna, *supra* note 97 (citing a study by Audit Analytics showing very low levels of shareholder support or involvement in efforts to hold gatekeepers accountable following compliance failures).
[221] *Cf.* COFFEE, *supra* note 20, at 145.
[222] *Supra* note 75.

extremely low. For example, *in pari delicto* reduces the likelihood of breach of contract and professional malpractice claims. A combination of pleading doctrines and shareholder information rights doctrines reduces the likelihood of corporate law claims. And demand futility doctrines reduce the likelihood of aiding-and-abetting claims in the context of officers' oversight duties. The fact that these doctrines function as pleading hurdles effectively blocks any case against compliance gatekeepers from reaching discovery. In turn, this reduces the incentives for institutional investors and entrepreneurial plaintiff attorneys to probe into potential gatekeeper failures to begin with. The lack of litigation is problematic mainly because it blocks the possibility of generating quality information on compliance gatekeepers' behavior. In other words, more than the compensation that could have been awarded in a given (rare) case, the lack of litigation deprives the market of its best chance of having quality information that will allow market actors to distinguish between high- and low-quality compliance gatekeepers.

Courts can relatively easily revive the threat of litigation against compliance gatekeepers.[223] All that is required is for the courts to exercise their discretion along the following four doctrinal dimensions.

First, courts could utilize more freely the "public-interest" exception to the *in pari delicto* defense.[224] In our context of outside gatekeepers who assume a role in flushing out information about corporate wrongdoing, it strains logic to immunize gatekeepers by imputing to the company knowledge of wrongdoing that would have been flushed out had said gatekeepers fulfilled their role.[225]

There is already a blueprint for courts to follow on this matter, and it comes from the *Rural/Metro* case and its progeny. There, the context was different but related, namely, third-party financial advisors whom boards hire when considering an M&A deal. Delaware's Supreme Court held that if the financial advisor knowingly created the informational vacuum that made the board breach its duties, said advisor can be held liable for aiding and abetting.[226] The application to our context is straightforward: *Caremark* duties were originally created to ensure that boards do not remain in an

[223] In general, maintaining a credible threat of gatekeeper liability is desirable when (1) the threat of market discipline of gatekeepers is limited, and (2) the threat of legal liability of corporate insiders is not enough to optimally deter corporate wrongdoing. *See generally* Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 888-93 (1984).

[224] AIG II; Kevin H. Michels, *The Corporate Attorney as "Internal" Gatekeeper and the In Pari Delicto Defense: A Proposed New Standard*, 4 ST. MARY'S J. LEGAL MALPRACTICE & ETHICS 318, 362 (2014).

[225] Michels, *id*. at 363. See also, in the context of third-party financial advisors, Singh v. Attenborough, 137 A.3d 151, 152-53 (Del. 2016).

[226] RBC, at 856, 862. *See also in re* TIBCO Software Inc. Stockholders Litig., 2015 Del. Ch. LEXIS 265, *81.

informational vacuum about their company's compliance efforts.[227] And boards heavily rely on compliance gatekeepers to ensure that relevant information flows to them.[228] If no relevant information reached the board, it seems reasonable to probe into whether compliance gatekeepers contributed to it.[229]

In the past, Delaware courts have based their refusal to apply the public-interest exception on the fact that the behavior in question was subject to heavy public regulation (in *Stewart*, for example, the primary wrongdoers were the heavily regulated insurance companies).[230] The thinking was that if there is another viable channel for holding corporate wrongdoers accountable, there is no reason to undermine *in pari delicto*'s rationale of saving the courts' resources and not adjudicating disputes between wrongdoers.[231] To us, such reasoning stands in contrast with the reasoning that Delaware courts have applied more recently, in director oversight duty cases. In *Marchand* and *Boeing* and *Clovis*, the courts suggested that it is precisely in highly regulated issues that director oversight duties are heightened.[232] Accordingly, it is precisely on these issues that directors will lean more heavily on professional advisors, to ensure compliance with mission critical regulatory requirements. It seems misguided to bar claims against gatekeepers in the areas where gatekeepers are relied on the most.

Second, courts could interpret Section 220 more liberally, thereby granting shareholders access to internal company documents in order for them to investigate potential wrongdoing on the part of compliance gatekeepers. Such a liberal interpretation is in line with recent Section 220 jurisprudence.[233] And it is also good policy. When the pleading standard is bad faith, as is effectively the case with compliance gatekeepers, there is a real risk that the underlying claim will turn into a toothless tiger. Such was

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[227] *See generally* Jennifer Arlen, *The Story of* Allis-Chalmers, Caremark, *and* Stone*: Directors' Evolving Duty to Monitor*, *in* CORPORATE LAW STORIES 323 (J. Mark Ramseyer, ed., 2009) (interviewing Chancellor Allen on what made him write the *Caremark* opinion in a way that reshaped director oversight duties).

[228] Part I *supra*.

[229] The focal point of aiding-and-abetting cases such as *Rural/Metro* is whether the fiduciaries *knowingly* contributed to the information vacuum. In the context of financial advisors in M&A transactions, the court has emphasized that the third parties in question are sophisticated and experienced (think i-bankers such as Goldman Sachs and JPMorgan), and so it is reasonable to infer that they knew that they were not providing the board with a full picture. Tibco, at *81. One distinction between our context of compliance advisors and the context of financial advisors to transformational deals, is that in the latter the third-party advisor usually has a clear, large stake in a certain outcome. As a result, it is easier to infer some self-interest on their part in not providing the board a full picture.

[230] Stewart, at 314.

[231] *Id*.

[232] Marchand v. Barnhill, at 822; *In re* Clovis Oncology, Inc. Derivative Litig., No. 2017-0222-JRS, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019).

[233] Section II.A *supra*.

the case in litigation against directors for compliance failures.[234] *Caremark* litigation amounted in its first twenty years to a parade of early dismissals.[235] It is only in the past three years and with a rise in Section 220 actions that *Caremark* has gained relevance. Elsewhere one of us has analyzed the pros and cons of the revamping of board oversight litigation, and found it likely to be overall desirable.[236] We believe that a similar revamping of gatekeeper litigation would be desirable too. And the only way to make such litigation feasible is to grant outside shareholders access to information that will allow them to provide pleading-stage indications of what the gatekeepers knew and when they knew it.[237]

The new, Section-220 driven mode of derivative actions for failures of compliance provides strong incentives for "bounty hunters" (institutional investor plaintiffs and their attorneys) to find out what went wrong and how. By keeping the pleading standard high, at bad faith, it places a premium on thorough pre-filing investigations. As a result, hunters can collect their bounty only when they add something to the mix of existing information. In director oversight duties, adding something means linking the directors to the corporate trauma.[238] With outside compliance gatekeepers, adding something would mean, for example, flushing out instances where the outsiders colluded with senior management or wore blinders. This recalibration of private litigation can counteract some of the failures of regulatory enforcement, such as its inability to hold individuals accountable, or its inability to distinguish between cosmetic compliance and effective compliance.

Third, courts could show willingness to fault compliance gatekeepers for "willful blindness." In other words, courts should be willing under certain narrow circumstances to fault gatekeepers not just for what we know they knew, but also for what they allowed themselves to not know.

The more common problem with compliance gatekeepers is seemingly not so much that they are in on the scheme, but rather that they have perverse incentives to look the other way before the fact, and not to investigate too closely after the fact.[239] In many of the postmortem analyses of compliance debacles, the outside gatekeepers claim in their defense that

[234] Shapira, New Caremark Era, *supra* note 73.
[235] Pollman, *supra* note 76.
[236] Shapira, Max Oversight Duties. *supra* note 83.
[237] *Stewart* in that regard is the exception that proves the rule: there, the case was brought by the Insurance Commissioner of Delaware, as Receiver in liquidation. The Receiver has much better access to corporate documents than public shareholders do in regular derivative actions.
[238] South v. Baker, 62 A.3d 1, 25 (Del. Ch. 2012).
[239] John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301, 345 (2004).

they were duped by insiders who hid their bad deeds from them.[240] While this may be factually correct, it raises the question of how the gatekeepers let themselves get duped this badly. Companies are paying them billions to be skeptical. Regulators are counting on them to curb corporate wrongdoing and to not be duped. Accordingly, "I was duped" should not be used as a get-out-of-sanctions-free card. There should be *some* background threat of digging into whether and why they got duped so badly.[241]

Here as well, there is a clear blueprint that the courts can follow. In corporate law, *Marchand* emphasized the need to sanction willful blindness in the context of director oversight duties.[242] In securities law, the Dodd–Frank act enlarged the scope of gatekeeper liability to cover recklessness and not just knowing violations, apparently acknowledging the need to fight off attempts to create plausible deniability.[243] We need a *Marchand* moment for compliance gatekeepers as well: namely, that there will be Section 220 production, and that courts will infer (in narrow circumstances) based on *absence* of evidence from the Section 220 production that the gatekeepers failed to report upward to the board about critical problems (for example).

Finally, courts could rethink the application of demand futility doctrines, so that they do not automatically trust directors' judgements on whether to pursue a failure-of-oversight claims against the company's officers or their third-party compliance advisors. Those who advise companies on how to implement reporting systems, and those who conduct internal investigations after the fact, are usually in position to point to where the bodies are buried. Accordingly, directors may have some concerns that a lawsuit against these compliance advisors might generate documents and testimonies that would shed a problematic light on directors' behavior.

To illustrate, let us recast the *Boeing* case. The decision painstakingly details how Boeing's top management lied to the regulators and withheld information from their own board. Yet, when it comes to liability, the *Boeing* decision lets management off the hook, based on demand futility doctrine. Because the plaintiffs apparently have not argued that Boeing's directors are beholden to its officers, there is no reason not to leave the decision on whether

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[240] COFFEE, *supra* note 20, at 47 (noting that in the many corporate governance scandals of the 2000s, the gatekeepers' "failings involved sins of omission, not commission… They were not active participants, but rather indifferent watchdogs who wore blinders"); McKenna, *supra* note 97.

[241] For more on why it may be desirable to sanction willful blindness see Jennifer Arlen, *Evolution of Director Oversight Duties and Liability under* Caremark*: Using Enhanced Information-Acquisition Duties in the Public Interest*, *in* RESEARCH HANDBOOK ON CORPORATE LIABILITY (Martin Petrin & Christian Witting, eds., forthcoming, 2023). The willingness to sanction willful blindness incentivizes both compliance insiders and compliance outsiders to generate paper trails. More robust paper trails, in turn, increases the costs of evading the law. *Cf.* Ann M. Lipton, *Beyond Internal and External: A Taxonomy of Mechanisms for Regulating Corporate Conduct*, 2020 WIS. L. REV. 657, 673 (2020).

[242] Section II.A *supra*.

[243] Andrew F. Tuch, *Multiple Gatekeepers*, 96 VA. L. REV. 1583, 1655 (2010) (analyzing the changes to Section 20(e) of the Securities Exchange Act).

the company should sue the latter to the former. But such an outcome is hard to reconcile with the facts of the case. Decisions such as how fast and at what costs to push a new model to the market, or how to react to an airplane crash, are usually not ones that are taken without board involvement. It is therefore debatable that we can trust directors with the decision of whether to pursue on behalf of the company a failure-of-oversight claim against management, given that such a lawsuit could very well flush out information on what the directors knew and when they knew it.

We acknowledge that some of these proposals, such as showing increased willingness to sanction willful blindness, could quickly deteriorate into hindsight bias on the part of the courts.[244] And so this may be a good time to discuss potential drawbacks to our proposals and how we think that courts can deal with them.

As with any proposal to recalibrate gatekeeper liability, courts and regulators should be careful to strike the delicate balance between more gatekeeper accountability and the costs of exposing gatekeepers to excessive risk of liability.[245] Indeed, a common refrain in the literature on traditional gatekeepers is that increasing the liability threat could increase the costs of gatekeeping, which in turn may restrict access to expert advice only to larger companies, which can afford it.[246] Applied here, one could claim that our proposals run the risk of compliance gatekeeping becoming off limits to smaller companies, which may be the ones needing it the most.[247]

While we acknowledge the risk of overdeterrence, the way to address it cannot be by zero deterrence.[248] It seems undesirable to almost never hold compliance gatekeepers accountable. Accordingly, some recalibration toward more accountability is needed. And there exist well-tested methods to ramp up accountability without falling into overdeterrence.[249] For example, courts could probe into compliance gatekeepers' behavior while capping the damages. In the rare cases in which gatekeepers will be forced to pay for contractual breach or professional malpractice or aiding-and-abetting breaches of fiduciary duties, the courts could cap the damages as a percentage of the gatekeepers' earnings.[250] Courts could also subject companies' recovery to comparative negligence and indemnification rights.[251]

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[244] Shapira, Max Oversight Duties, *supra* note 83.
[245] Christine M. Shepard, *Corporate Wrongdoing and the In Pari Delicto Defense in Auditor Malpractice Cases: A New Approach*, 69 WASH. & LEE L. REV. 275, 322 (2012).
[246] Assaf Hamdani, *Gatekeeper Liability*, 77 S. CAL. L. REV. 53 (2003).
[247] *Id*.
[248] Schaefer, *supra* note 126, at 1035.
[249] DeMott, supra note 127.
[250] *Id*. at 353.
[251] *Id*; AIG I, supra note 133, at 828 n.246. To be sure, a comparative negligence analysis in our context will be a resource-intensive, very challenging endeavor. As Professor DeMott noted: "it may be difficult to unscramble the strands of multi-party responsibility when managerial fraud goes

Further, our proposed recalibration is not likely to lead to an explosion of litigation against gatekeepers, if only because the evidentiary bar remains high at the "bad faith" level. What the proposal does is simply provide public shareholders with better tools (pre-filing discovery) to meet this high bar under the right circumstances.

There is a broader point at play here. The most badly needed change is not that gatekeepers pay out of pocket for compliance failures, but rather that there be a channel for flushing out information about the compliance process and what went wrong with it.[252] This is why a combination of better tools to survive the pleading stage, on the one hand, and methods to limit gatekeepers' liability exposure such as comparative negligence, on the other hand, is preferable in our mind. Granted, the impetus behind applying doctrines such as *in pari delicto* as a pleading hurdle was to avoid getting into such complex factual determinations.[253] Yet our analysis highlights the hitherto-ignored positive externality that stems from such fact-intensive litigation, namely, that it injects quality information into the market and thereby facilitates reputational discipline.

B. Lessons for Regulators

Our analysis offers a couple of big-picture lessons for regulators. At the most basic level, regulators should acknowledge that outside advisors play an outsized role in corporate compliance yet are rarely accountable for compliance failures. From there, regulators can derive several types of implications. For one, regulators should rethink the desirability of providing lenient treatment to corporate wrongdoers because they relied on outside experts. Perhaps credit to wrongdoers should be conditioned on outside experts facing a meaningful threat of liability, or at minimum some form of discovery of their process.[254]

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undetected, perhaps sorting the consequences of a design flaw in an internal control system from subsequent flaws in audit procedures and distinguishing both from errors made by the client's directors." *Id*. at 352. Still, the willingness to engage in comparative analysis, however costly in a given case, will provide the right incentives ex ante and inject much-needed quality information to the market ex post, thereby facilitating reputational discipline of the compliance governance apparatus. For more on how comparative negligence analysis helps reputation markets see Assaf Jacob & Roy Shapira, *An Information-Production +Theory of Liability Rules*, 89 U. CHI. L. REV. 1113, 1142 (2022).

[252] *Cf.* other works emphasizing the outsized role of the process in corporate law litigation, such as James An, Substance and Procedure in Corporate Law (working paper, 2023) (on file with author); Lawrence A. Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, 42 IOWA J. CORP. L. 597 (2017).

[253] Stewart v. Wilmington, 112 A.3d 271, at 302 ("because the main purpose of *in pari delicto* would be undermined by fact intensive proceedings comparing the culpability of the wrongdoers, the defense may be raised successfully on a motion to dismiss").

[254] *Cf.* Root Martinez, *supra* note 36 (advocating for "greater publicness in monitor reporting").

The question then becomes whether regulators can do something to increase gatekeeper accountability. For instance, regulators should rethink whether and how to rely on self-regulatory solutions. Regulators often rely on enforcement through self-regulatory bodies in the context of professionals such as law firms and accounting firms.[255] The idea sounds good on paper: the industry will supposedly have strong incentives to police itself to maintain its reputation and quality. But on-the-ground evidence provides much reason for skepticism.[256] As one notable commentator remarked, self-regulation of accountants resembles "a toothless system of professional discipline,"[257] and self-regulation of lawyers "has been conspicuous mainly by its absence."[258] The accumulated experience suggests that self-regulation works effectively only when it is accommodated by frequent law enforcement actions or market discipline.[259] When left to their own devices and without an external check, self-regulatory bodies drift toward emphasizing the semblance of being tough without really being tough on their peers.[260]

One straightforward step that regulators can take in that regard is ensuring the publicness of dispute resolution mechanisms. Arbitration behind closed doors inhibits necessary feedback mechanisms for self-regulation.[261] Regulators should therefore demand that self-regulatory bodies make reports about misbehaving firms and individuals public, so that they inject quality information to the market and thereby facilitate reputational discipline.[262]

Still, in our context transparency in self-regulation can hardly be a panacea. To illustrate, consider the case of regulating auditor misconduct via the Public Companies Oversight Board (PCAOB). The PCAOB was created following the Sarbanes–Oxley Act of 2002, to review and grade the audits of public companies.[263] The PCAOB reports are eventually made public, thereby supposedly creating a database that could allow the market to distinguish between high- and low-quality gatekeepers. Yet in reality the openness of PCAOB's reviews provides limited help. For one, it is not clear

[255] For a thorough analysis in a distinct-but-related context see Andrew F. Tuch, *The Self-Regulation of Investment Bankers*, 83 GEO. WASH. L. REV. 101 (2014).
[256] Benjamin P. Edwards, *The Dark Side of Self-Regulation*, 85 U. CIN. L. REV. 573, 604 & n.197 (2017) (compiling references for criticisms).
[257] COFFEE, *supra* note 20, at 169.
[258] *Id*. at 229.
[259] *See, e.g.*, Jodi L. Short & Michael W. Toffel, *Coerced Confessions: Self-Policing in the Shadow of the Regulator*, 24 J. L. ECON. & ORG. 45 (2007) (noting that self-regulation works only in the shadow of frequent regulatory inspections and enforcement actions); Cary Coglianese & Jennifer Nash, *Motivating without Mandates? The Role of Voluntary Programs in Environmental Governance*, *in* ELGAR ENCYCLOPEDIA OF ENVIRONMENTAL LAW 237 (Michael Faura, ed., 2016) (noting same).
[260] Edwards, *supra* note 256, at 599, 610.
[261] *Id*. at 600.
[262] *Id*. at 612.
[263] After the 2008 financial crisis, the Dodd-Frank Act and Consumer Protection Act of 2010 further expanded its oversight responsibilities.

that the PCAOB disciplines all or even most cases of compliance gatekeeper misconduct. To recast our Wells Fargo example, KPMG was not disciplined.[264] Indeed, when we searched the PCAOB database for instances concerning compliance gatekeeping misconduct, we found only a handful of enforcement actions investigating auditors' failures to react to their clients' illegalities.[265]

Ultimately, regulators' best bet to increase gatekeeper accountability may be probing into gatekeeper misconduct on their own, within public enforcement actions. Such a move will require regulators to drastically shift their current priorities, however. Regulators have incentives to go after small, strict-liability type offenses, in ways that maximize the number of enforcement cases being brought and the amount of fines being collected.[266] It is therefore unsurprising that regulators have deprioritized enforcement actions against the big accounting and law firms.[267] Such enforcement actions tend to be extremely costly, sapping regulators of their limited resources.[268] Once regulators shift their priorities and start digging out information gatekeeper misconduct, their investigations will likely also revive the prospect of private litigation.

Perhaps the broader (and somber) lesson for regulators is the need to buttress other mechanisms for flushing out corporate misbehavior. The overarching theme of our analysis is the mismatch between the outsized role that compliance gatekeepers play and their low levels of accountability for compliance failures. Private litigation against them is an uphill battle. Reputational discipline of them is diluted. One cannot therefore count on gatekeepers' ability to meaningfully curb corporate wrongdoing. Regulators should be skeptic toward the effectiveness of corporate compliance programs. And they should buttress other mechanisms that can flush out damning information, such as incentivizing whistleblowers and not cracking down on short sellers. To recast our Enron example: it was not the outside legal advisor or auditor that flushed out misconduct. In fact, the gatekeepers were the ones whitewashing indications of wrongdoing. It was rather a whistleblower and

[264] Michael Cohn, *Elizabeth Warren Questions PCAOB about KPMG Audits of Wells Fargo*, ACCOUNTING TODAY (Apr. 27, 2017), https://www.accountingtoday.com/news/elizabeth-warren-questions-pcaob-about-kpmg-audits-of-wells-fargo.

[265] Auditors are required by the PCAOB Interim Auditing Standard ("AU") § 317 to take certain actions when they become aware of illegal acts by their clients.

[266] Urska Velikonja, *Reporting Agency Performance: Behind the SEC's Enforcement Statistics*, 101 CORNELL L. REV. 901, 903, 908 (2016); Roy Shapira, *A Reputational Theory of Corporate Law*, 26 STAN. L. & POL'Y REV. 1, 54 (2015).

[267] COFFEE, *supra* note 20, at 62.

[268] *Id*. at 155.

a short-seller who enlisted the help of investigative reporters, which eventually flush out the damning information.[269]

C. Lessons for Academics

Our analysis also offers a couple of big-picture lessons for academics. First and most basically, corporate governance scholars need to delve deeper into *compliance governance*. Academics should resist the temptation to assume that compliance efforts are necessarily dedicated and zealous. There is a dearth of controlled studies examining whether compliance programs justify the huge investment in them. And we have highlighted several theoretical and empirical reasons to be skeptical about the optimality of the existing equilibrium. Both the service providers and their direct clients have little interest in delivering better compliance gatekeeping, because the costs of less-than-ideal compliance gatekeeping are largely externalized on public shareholders and society at large.

In that regard, our analysis here is closely related to studies of "cosmetic compliance."[270] These studies point out that corporations treat compliance more as a check-the-box exercise providing insurance against sanctions than as a system meant to truly root out corporate misconduct. Our analysis here spotlights the role of third-party advisors in making compliance potentially more cosmetic, for example by lending it legitimacy.[271]

This brings us to our second point. Academics should look more closely at the interactions between two literatures that have thus far existed largely in silos, namely, compliance and gatekeepers. The literature on compliance failures has focused mostly on insiders, such as directors and chief compliance officers.[272] It has hitherto ignored the outsized role that outside compliance advisors play.[273] The literature on gatekeeper failures has focused mostly on financial reporting. It has thus far understudied the

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[269] COFFEE, *supra* note 20, at 36. For a more systematic empirical study showing that "it takes a village" to unveil corporate fraud see Alexander Dyck, Adair Morse & Luigi Zingales, *Who Blows the Whistle on Corporate Fraud?*, 65 J. FIN. 2213, 2214 (2010).

[270] Krawiec, *supra* note 53; William S. Laufer, *Corporate Liability, Risk Shifting, and the Paradox of Compliance*, 52 VAND. L. REV. 1341 (1999); Brandon L. Garrett & Gregory Mitchell, *Testing Compliance*, 83 L. & CONTEMP. PROBS. 47, 50-51 (2020).

[271] *See also* Francine McKenna, *Deloitte and Standard Chartered Bank: In Service to Profit Above All*, FORBES (Aug. 7, 2012).

[272] Harper Ho, *supra* note 6, at 247.

[273] To some extent, these compliance outsiders create the informational environment that corporate boards and compliance insiders operate in. *Cf.* COFFEE, *supra* note 20, at 7 (in the context of traditional gatekeepers); Omari Scott Simmons, *The Corporate Immune System: Governance from the Inside Out*, 2013 U. ILL. L. REV. 1131, 1160 (2013) (in the context of boards' reliance on officers to create the proper information environment); Kobi Kastiel & Yaron Nili, *Captured Boards: The Rise of Super Directors and the Case for a Board Suite*, 2017 WIS. L. REV. 19. 23 (2017) (on the "informational capture" dynamics that plague boards).

different dynamics that apply to gatekeepers who oversee compliance with regulatory requirements that are meant not necessarily to protect shareholders but rather to protect broader societal interests, such as preventing environmental degradation. Merging the insights of these two academic literatures could help us advance our understanding of the all-important topic of compliance governance.

Third, academics should start treating compliance governance as a corporate law issue. While corporate law has historically remained remarkably silent on compliance, in recent years Delaware courts have revamped director oversight liability and acknowledged officer oversight liability.[274] We conjectured that the January 2023 *McDonald's* decision,[275] which recognized officer oversight duties, may revamp the prospect of litigation against compliance gatekeepers. Outside compliance advisors usually work directly with top officers. It is less likely that the advisors were conspiring with directors, but more likely that the advisors opted to remain blind to bad faith on the part of the officers who hire and work with them.

When taking the corporate law angle to compliance governance, academics should address the thorny issue of who compliance is for. One could claim that in at least some of the scenarios that we have been covering here, the purported role of the law is not to mitigate agency problems but rather to *create* an agency problem.[276] Shareholders may benefit from a situation whereby gatekeepers bring legitimacy and leniency to their company, while not really curbing profitable-yet-legally-questionable behavior. From this angle, our proposals to facilitate aiding-and-abetting *Caremark* claims or carving exceptions to In Pari Delicto could be read as another step toward a "welfarist" approach to corporate law.[277]

CONCLUSION

[274] *Supra* note 102.
[275] *Id*.
[276] Arlen, *supra* note 241.
[277] On the welfarist approach see Marcel Kahan & Ed Rock, Corporate Governance Welfarism (working paper, 2023), https://ssrn.com/abstract=4328626. In the abovementioned *McDonalds*, Vice Chancellor Laster offered a breakdown of the relevant claims into an "Information Systems" claim (pace *Caremark*), a "Red Flags" claim (pace *Allis Chalmers*), and a "Lawbreaking" claim (pace *Massey*). Under this categorization, some of our scenarios concern aiding-and-abetting *Massey* claims rather than aiding-and-abetting *Caremark* claims. For more references on the well-developed caselaw proclaiming that "corporate law does not charter lawbreakers" see Asaf Raz, *The Legal Primacy Norm*, 74 FLA. L. REV. 933 (2022). To be sure, one could question the effectiveness of relying on the tool of shareholder litigation to address behaviors that are good for shareholders but bad for society overall. *See also* Jessica Erickson, *Corporate Misconduct and the Perfect Storm of Shareholder Litigation*, 84 NOTRE DAME L. REV. 75, 103 (2008) (on the debate regarding the "public" features of derivative suits).

Corporate compliance has become a critical issue in corporate governance,[278] and outside gatekeepers play a critical role in corporate compliance. Understanding the role of compliance gatekeepers and what can be done to improve their effectiveness are therefore timely, but hitherto understudied, questions. This Article highlighted just how big a role compliance gatekeepers play, explained why they nevertheless escape accountability when compliance fails, and suggested ways to mitigate the accountability gap.

The best way to clarify this Article's original contributions is by acknowledging their limitations and juxtaposing them to the extant literature.

One could question our focus on compliance outsiders rather than compliance insiders. The fact that a company violated the law does not mean that its compliance gatekeeper failed. After all, if corporate insiders truly want to engage in wrongdoing and conceal it, it would be hard even for the most competent, public-spirited outside gatekeeper to stop them. And if the board or general counsels do not get (do not want to get?) good results from their handsomely paid outside advisors, they should be the ones being held accountable, or so the argument goes.

Our rebuttal is straightforward: nowhere in this Article do we assume that outside professionals can completely eradicate corporate wrongdoing. Our purpose here was more modest, namely, to challenge the prevalent assumptions that heavy investment in corporate compliance and heavy reliance on compliance outsiders are justified. If the argument is that compliance outsiders will never be able to be effective compliance gatekeepers, why do companies pay them billions annually and regulators regularly count on their ability to deliver? By examining the role of compliance gatekeepers, we intend to redirect the extant literature to a comparative institutional analysis mode that explores the relative advantages and disadvantages of compliance insiders and compliance outsiders and considers how best to merge them.

A related limitation concerns the relative dearth of systematic empirical evidence on the effectiveness of compliance gatekeepers. One could therefore argue that we cannot determine that the current situation is problematic and needs to be addressed. After all, the optimal level of compliance failures is not zero, as it must be weighed against the direct and indirect costs of compliance programs.

We acknowledge that figuring out the exact conditions under which compliance gatekeepers can be effective is an issue that does not lend itself to clear empirical proofs or neat models. Companies keep their compliance cost structure secret, and do not volunteer information on why their compliance programs failed. Yet neither the fuzzy nature of this topic nor the

[278] Veronica Root, *Coordinating Compliance Incentives*, 102 CORNELL L. REV. 1003, 1004 (2017).

nascent state of our understanding of it should deter us from delving into it further, if only because the stakes are high. Even without taking a strong position on what portion of the blame should be assigned to outside gatekeepers, we were able to spotlight the surprising gap between the high expectations for compliance gatekeepers and the virtually zero accountability for compliance failures. Our main purpose here was to put forward a call for academics, regulators, and practitioners to think harder about the correct levels of compliance gatekeeper accountability and how to achieve them.

A third limitation comes from considerations of scope and brevity: our analysis here occasionally lumped together several compliance gatekeeping functions that present different dynamics and different dilemmas. Future work should delve more deeply into the variation between, say, professionals who reduce the exposure to liability once compliance failures occur (compliance investigations) and professionals advising the company on how to meet regulatory requirements to begin with (compliance intelligence). Future work could also explore the variation across different compliance areas, identifying the areas in which insiders want gatekeepers to be as diligent as possible versus the areas in which insiders want gatekeepers to be lenient and let the former profit from skirting regulations.

The potential for contributions that were not developed here only strengthens the message that much work remains for legal scholars in understanding the role of outside compliance advisors. In an era when compliance is the new corporate governance, legal scholars, regulators, and practitioners cannot afford to continue ignoring the actors that dictate the effectiveness of corporate compliance. This Article represents a step toward injecting much-needed theory and evidence into the discussion.

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