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Cultures of Compliance

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ABSTRACT: In the last few years especially, law-makers have increasingly invoked *culture* as something crucial to good compliance. The phrase "culture of compliance" has thus made its way into common legal discourse as describing both a goal and a marker. Precisely they mean by this is contestable, but there is enough evidence that the demand for healthy compliance culture is serious to invite careful thought. What is it, or should it be, and how might we know? This article draws from organizational behavior, behavioral ethics, and financial economics to develop an approach to how and why corporate cultures resist naively appealing interventions of "tone at the top" and ethical exhortation. Though recognizing the limited institutional capacity of government enforcers to promote structural changes in corporate governance and internal controls, the article concludes that any hope of getting to a socially optimal level of compliance—including a healthy culture of compliance—depends on a strong public voice to counter the beliefs and biases that grease internal perceptions of how firms succeed. In the end, however, the most important message about cultures of compliance is for corporate leaders and, especially, boards of directors. It is much too easy to look around and see good people working hard at difficult jobs and assume that a good compliance culture exists simply because everyone has been warned of the damage that can come from getting caught doing wrong. Or worse, to assume that an observable abundance of intensity, loyalty and creativity are signs that all is good. Taking culture seriously—appreciating the opportunities for transmitting values as well as anticipating the many hidden pathways of resistance and denial—is a necessary step toward the sort of compliance that never attracts prosecutors' unwanted attention.

In mid-2015, the American Law Institute began a project to draft principles of legal compliance in organizations.[1] The task is challenging, but worth the effort. Today, compliance—a key form of preventive law—attracts a rapidly increasing amount of corporate attention and resources. Common practices diffuse from business to business, seemingly more from conformity pressures than hard evidence of what works and what doesn't. To quote one unusually candid compliance officer: "In the end, do we know if we have an effective program? We haven't figured that out yet. We do know we have a

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[1] ALI, Principles of the Law of Compliance, Enforcement and Risk Management at Corporations, Nonprofits and Other Organizations, available at https://www.ali.org/projects/show/compliance-enforcement-and-risk-management-corporations-nonprofits-and-other-organizations/.

program in size. We just don't know if it works."[2] Consultants and vendors advocate a seductive (and often expensive) set of ideas, products and services to corporate officers and directors in the name of self-protection, abetted by in-house compliance personnel who covet the additional resources and status. Government enforcers now claim compliance as their territory to police, about which executives are especially wary. In sum, compliance is fascinating and important, worthy of sustained, systematic study. [3]

Socio-legal scholars who study white collar crime have long been interested in the preventive mechanisms that reduce the reputational and liability risk that organizations face when managers and employees misbehave, and researchers interested in corporate law have been commenting on the viability—and genuineness—of these mechanisms from social deviance and agency cost perspectives for quite some time. That much is not new.[4]

What has changed is a noticeable uptick in the demand from lawmakers for the adoption of large-scale state-of-the-art compliance systems. Especially insistent have been criminal prosecutors from the Department of Justice, who—with prompting from the Organizational Sentencing Guidelines—have made the quality of compliance at a given firm relevant to both charging decisions and the level of fines and reform sanctions sought or imposed.[5] Non-prosecution and deferred prosecution agreement routinely impose intrusive governance and compliance reforms on corporations in the apparent belief that they will make recidivism less likely.[6] There is now a dedicated compliance specialist at DOJ.[7] Other federal agencies have long been part of this campaign as well, in their civil

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[2] Quoted in Sean J. Griffith, *Corporate Governance in an Era of Compliance*, 57 Wm. & Mary L. Rev. 2075, 2106 (2016).

[3] To this end, NYU has created a Program on Corporate Compliance and Enforcement; its blogsite is available at https://wp.nyu.edu/compliance_enforcement/. The first compliance casebook has emerged for adoption in law schools. GEOFFREY P. MILLER, THE LAW OF GOVERNANCE, RISK MANAGEMENT AND COMPLIANCE (2014).

[4] A classic study is CHRISTOPHER D. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR (1975).

[5] See Julie R. O'Sullivan, *How Prosecutors Apply the "Federal Prosecutions of Corporations" Charging Policy in the Era of Deferred Prosecutions, and What That Means for the Purposes of the Federal Criminal Sanction*, 51 Am Crim. L. Rev. 29 (2014).

[6] For data on the kinds of compliance and governance changes required, see Wulf Kaal & Timothy Lacine, *The Effect of Deferred Prosecution Agreements and Non-Prosecution Agreements on Corporate Governance: Evidence from 1993-2013*, 70 Bus. Law. 1 (2014). On the many issues raised by these practices, see BRANDON GARRETT, TOO BIG TO JAIL: HOW PROSECUTORS COMPROMISE WITH CORPORATIONS (2014); ANTHONY BARKOW & RACHEL BARKOW, EDS., PROSECUTORS IN THE BOARDROOM: DETERRING CRIME WITHOUT INTERFERENCE IN CORPORATE GOVERNANCE (2011). As to the SEC, see Jayne W. Barnard, *Corporate Therapeutics at the Securities and Exchange Commission*, 2008 Colum. Bus. L. Rev. 795.

[7] See *DOJ Compliance Expert Focuses on Real-World Applications, Not Legal Jousting*, 48 Sec. Reg. & L. Rep. (BNA) 1379 (July 11, 2016).

enforcement efforts and in the oversight of supervisory and risk management responsibilities for firms under their jurisdiction.[8] Not surprisingly, this increased stress on compliance is global, not just domestic.[9] As a result of the increase in demand, much more scholarly and practice-focused attention is turning to compliance in a pressure-cooker world.[10] Much of it is critical of current policies and practices.[11]

In the last few years especially, law-makers have increasingly invoked *culture* as something crucial to good compliance. The phrase "culture of compliance" has thus made its way into common legal discourse as describing both a goal and a marker.[12] Precisely they mean by this is contestable, but there is enough evidence that the demand for healthy compliance culture is serious to invite careful thought.[13] What is it, or should it be, and how might we know? That is my topic here.

Practitioners may cringe at academics' wish for inclusion in this discussion, fearing interventions that are impenetrable and pretentious. Corporate

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[8] This is especially so in financial services. For an excellent collection of materials, see DAVID H. LUI & JOHN H. WALSH, EDS., MODERN COMPLIANCE: BEST PRACTICES FOR SECURITIES AND FINANCE (2015). Environmental law, privacy law, healthcare law, foreign corrupt practices and defense contracting are other compliance hot spots, and anti-terrorism efforts are quickly knitting together many different regulatory subject areas where businesses are increasingly called upon to be on the lookout and assist in fighting terror threats.

[9] John H. Walsh, *A History of Compliance*, in LUI & WALSH, supra, at 49-60.

[10] E.g., Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. Rev. 949 (2009); D. Daniel Sokol, *Policing the Firm*, 85 Notre Dame L. Rev. 785 (2013); James Fanto, *Surveillant and Counselor: A Reorientation of Compliance for Broker-Dealers*, 2014 BYU L. Rev. 1121; Maurice E. Stucke, *In Search of Effective Ethics & Compliance Programs*, 39 J. Corp. L. 769 (2014); Griffith, supra; Todd Haugh, *The Criminalization of Compliance*, Notre Dame L. Rev. (forthcoming), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2752621. For other discussions, see sources cited in notes --- infra.

[11] A number of prominent legal scholars have recently made the point that another conceptual darling of regulators today—corporate governance, especially the role of independent directors—has been similarly misconstrued and misapplied. See Jennifer Arlen & Marcel Kahan, *Corporate Governance Regulation through Non-Prosecution*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2731351; Lawrence Cunningham, *Deferred Prosecutions and Corporate Governance: An Integrated Approach to Investigation and Reform*, 65 Fla. L. Rev. 1 (2014); Griffith, supra. On the politics of director independence, which extends well beyond this particular subject, see Urska Velikonja, *The Political Economy of Board Independence*, 91 N.C. L. Rev. 855 (2014).

[12] E.g., Michele DeStefano, *Creating a Culture of Compliance: Why Departmentalization May Not Be the Answer*, 10 Hastings Bus. L.J. 71 (2014); Miriam H. Baer, *Too Vast to Succeed*, 114 Mich. L. Rev. 1109, 1115 (2016); Griffith, supra, at 1093. A particularly strong statement from a New York Federal Reserve Board official is Thomas C. Baxter, *The Changing Face of Corporate Compliance and Corporate Governance*, 21 Fordham J. Corp. & Fin. L. 61 (2016).

[13] Scholarly interest in the criminal law of corporate culture and character is not new. See, e.g., Pamela Bucy, *Corporate Ethos: A Standard for Imposing Corporate Criminal Liability*, 75 Minn. L. Rev. 1095 (1991); Susanna M. Kim, *Characteristics of Soulless Persons: The Applicability of the Character Evidence Rule to Corporations*, 2000 U. Ill. L. Rev. 763.

cultures are inseparable from the larger societal culture, which can set off abstruse definitional and substantive debates. (Marx and Weber appear in serious academic incantations, with post-moderns like Foucault[14] and Derrida.) This article will try to stay as grounded and helpful as possible to regulators, lawyers and the growing legions of compliance personnel, in the constructive spirit of the ALI project. Empirical social science work relating to how cognition and culture in business organizations affect law-abidingness (and much else) is burgeoning, and offers many useable insights.[15] Yet practice in the field—by the regulators who insist on cultural interventions, or the lawyers and compliance people who have to carry out the mandates—has not yet been particularly well informed by what we know or surmise, but rather based more on hope or intuition. That is a problem, at least if the cultural turn in compliance is serious.

So, what follows is a series of observations drawn from different social sciences—economics, psychology, sociology and anthropology—about cultures of compliance and noncompliance. Culture is crucial to good compliance, worth government's attention. However, as with so many social phenomena, unexpected consequences and connections abound, defying easy manipulability in some preferred direction. A recent empirical study illustrates two points.[16] The widely-publicized hacking of the Ashley Madison dating website (for adulterous affairs) offered researchers a trove of data, and it wasn't difficult to then draw from publicly-available SEC disclosures to identify top executives at public companies who were cheating on their spouses via that presumably private service. Hence the question: is legal compliance at companies with greater than average clusters of adulterers different from others? Using various metrics of corporate law-abidingness (e.g., subsequent financial misstatements), the answer was—at the level of statistical significance—yes. Upper-echelon character seems to matter beyond merely personal affairs, which is relevant to an important debate about culture and compliance.

Interesting enough, but that was not the punch line. Rather it was that companies with higher incidence of executive-cheaters were also more creative and inventive, with higher incidence of patent grants and other tangible indicators

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[14] To whom citations pertaining to compliance are actually quite apt. See Fanto, supra, at 1148-51.

[15] E.g., LINDA K. TREVIÑO & GARY WEAVER, MANAGING ETHICS IN BUSINESS ORGANIZATIONS: SOCIAL SCIENTIFIC PERSPECTIVES (2003); Henrich R. Greve, *Organizations Gone Wild: The Causes, Processes and Consequences of Organizational Misconduct*, 4 Acad. Mgt. Annals 53 (2010). For my commentaries (with citations relating this literature) on behavioral challenges to securities regulation and enforcement, see DONALD C. LANGEVOORT, SELLING HOPE, SELLING RISK: CORPORATIONS, WALL STREET AND THE DILEMMAS OF INVESTOR PROTECTION (2016).

[16] William D. Greiser et al., *Fifty Shades of Corporate Culture*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2741049 (June 28, 2016).

of innovation. That would not surprise psychologists, who have uncovered solid experimental evidence linking cognitive creativity and unethical behavior.[17] But it illustrates the conundrum that the origins of noncompliance may be found in seemingly benign—even prized—behaviors, traits and cultural artifacts that are thought to generate success in a hyper-competitive marketplace. The point here is not that compliance should be demoted in the name of innovation, but simply that once we start trying to nudge culture, we may get more than the desired response, if we even get that.[18] Those engaged in promoting better compliance have to be good students of the social science, not naïve intuitionists.

The goal for regulatory and self-regulatory actors is to know how to assess the difference between good and bad compliance systems and cultures, or more precisely, how to array any given system on the lengthy continuum running from good to bad. This requires a deep anthropological knowledge of the firm and its people in the face of ample incentives to dress up to fool the casual visitor. We are far enough along in the law of compliance that all major firms do something in the name of compliance, often with checklists at hand of "to do" items. Successful firms are usually adept at impression management,[19] and managers and employees often believe their own myths. The masks they put on will not be easy to see through.

I. Compliance Theory and Practice

A. The ABCs of Compliance

If the law imposes the right mix of detection and sanctions, firms will for that reason alone have an incentive to take steps to reduce legal risk. This is especially so in a legal regime, like the U.S., that uses *respondeat superior* as the standard for corporate criminal liability, whereby the corporation is liable for any

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[17] See Francesca Gino & Dan Ariely, *The Dark Side of Creativity*, 102 J. Pers. & Soc. Psych.445 (2011); see also Francesca Gino & Scott Wiltermuth, *Evil Genius? How Dishonesty Can Lead to Greater Creativity*, 25 Psych. Sci. 973 (2014).

[18] Todd Haugh uses the example of Intel's antitrust compliance, which received plaudits for its aggressive, cutting edge approach. David Yoffie & Mary Kwak, *Playing by the Rules: How Intel Avoids Antitrust Litigation*, 79 Harv. Bus. Rev. 119 (2001). Not long thereafter, Intel found itself in massive antitrust trouble, with some suspicion that not only did the style of its compliance program fail to deter the problem; it may have contributed to it. Haugh, supra, at 2-5, 58-59.

[19] See generally Scott Highhouse et al., *An Organization Impression Management Perspective on the Formation of Corporate Reputations*, 35 J. Mgt. 1481 (2009).

crime or misbehavior by any agent acting within the scope of authority and at least partially to benefit the firm. Because there is no good faith or reasonable efforts excuse, the firm bears substantial liability risk, and has an incentive to reduce it.[20] The public benefits from precautionary investments in legal compliance that minimize the net social costs of law violations committed by agents of the corporation. A socially optimal compliance program, then, can be defined what "a rational, profit-maximizing firm would establish if it faced an expected sanction equal to the social cost of the violation."[21] For any given firm, we will describe this optimal, compliance-inducing expected sanction as point "A."

It seems widely agreed that the amalgam of corporate liability risks actually faced by a firm at any given time is less than A, perhaps considerably so. There are many reasons: limited regulatory resources, detection difficulties, legal uncertainties and procedural obstacles, conflicts of interest, political pressure, etc.[22] To use a good example of great relevance to contemporary compliance, Jonathan Karpoff and colleagues recently estimated the average sanction of a Foreign Corrupt Practices Act anti-bribery violation as *nine times* too low at current rates of detection compared to the expected gains.[23] Enforcement is at best cyclical, moreover, and periods of severe under-enforcement (usually during boom times) can produce "compliance rot."[24] Let's posit that a firm would rationally assess its actual liability exposure at the moment in light of these limitations as point "B."

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[20] See O'Sullivan, supra. On the other hand, strict liability may lead in the opposite direction, where companies fear that their preventive efforts will uncover wrongdoing that creates liability that otherwise would not have been uncovered. There are multiple consequences to such a rule, some perverse. See Jennifer Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. Leg. Studies 833 (1994)(diminished incentive to discover illegality). Outside of criminal law, *respondeat superior* may not aptly describe the liability standard for corporations for acts of their agents. Nonetheless there is usually ample room for derivative corporate liability, so that we can ignore these legal distinctions in our discussion of culture.

[21] See Geoffrey P. Miller, *An Economic Analysis of Effective Compliance Programs*, in JENNIFER ARLEN, ED., RESEARCH HANDBOOK ON CORPORATE CRIME AND FINANCIAL MISDEALING (forthcoming, 2017). As Miller points out, there are multiple combinations of detection probabilities and sanction levels that can be employed in search of this ideal point, which will affect corporate behavior differently depending on risk aversion, etc.

[22] See Daniel Richman, *Corporate Headhunting*, 8 Harv. L. & Policy Rev.265, 273-74 (2015).

[23] Jonathan Karpoff et al., *The Value of Foreign Bribery to Bribe Paying Firms*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1573222 (June 16, 2015), p.29. See also John Connor & Robert Lande, *Cartels as Rational Business Strategy: Crime Pays*, 34 Cardozo L. Rev. 427 (2012).

[24] See ERIK GERDING, LAW, BUBBLES AND FINANCIAL REGULATION 2, 10-11 (2013)(describing cyclical periods of "compliance rot" during economic booms).

If B is less than A, then there will presumably be too much corporate misbehavior and insufficient investment in compliance.[25] While the most direct response is to raise the liability exposure (hence moving B closer to A), that may not be feasible. Inducing more compliance effort through either incentives or positive legal command then becomes an attractive second-best alternative. The goal is to incentivize or force a control system inside the firm that has the practical effect of reducing wrongdoing that otherwise would have a positive expected value.[26]

Our definition of B places it at the optimal point for the firm's risk-return calculus, as opposed to society's optimal precaution point. But where managers' actual beliefs are about wrongdoing and compliance—which we'll label point "C"—varies. At an exemplary complier C will be closer to A. A more venal firms C will be on the wrong side of B, further away from A. Many forms of corporate wrongdoing are committed by managers in their own selfish interest, not the firm's. The CEO and senior management team may have short-term incentives and materialistic ambitions. A crime might pay off for them now, but be sanctioned only later, if at all. Although individual sanctions of various sorts are possible—and not trivial—there is no reason to assume that the expected payoff from wrongdoing is the same for the managers as opposed to the company. These are agency cost problems, which corporate governance may not be strong enough solve.[27]

The distinctions among A, B and C may seem self-evident, but they are not. In the decades since compliance became a field of practice, it has been viewed mainly in terms of agency costs and fiduciary responsibilities—how to get managers to avoid selfish (disloyal) or ignorant (careless) behaviors that pose an unacceptable risk of liability for the firm and its shareholders.[28] That is, how to get to B, but not necessarily any further. As a result, best practices reflect that

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[25] To be sure, there are efficiency *benefits* from compliance as well. See Robert C. Bird & Stephen Kim Park, *Turning Corporate Compliance into Competitive Advantage*, 19 U. Pa. J. Bus. L. (forthcoming, 2017).

[26] See Miller, supra. On the larger effort to internalize compliance responsibilities by forcing corporate cooperation with prosecutors, see Samuel W. Buell, *Criminal Procedure within the Firm*, 59 Stan. L. Rev. 1613 (2007).

[27] How much corporate wrongdoing is disloyal and how much is meant to help the firm is debatable. My impression is that most wrongdoing has both elements intertwined, which complicates the compliance function considerably. See note --- infra. In addition, agency costs no doubt drive some unwillingness to demand high-quality compliance for fear of the personal liability for those at the top that comes from being made aware of the risk of wrongdoing (i.e., the desire for "plausible deniability").

[28] That assumes the orthodoxy of shareholder primacy, which is actually quite contestable. Indeed, the debate over getting to point A encompasses many of the challenges to the shareholder wealth maximization model. See pp. ---- infra.

corporate self-protective strategy, which is testable by whether the steps would add to or subtract from the value of the firm. By contrast, while the government does have an interest in reducing agency costs to the extent they produce more corporate crime, merely getting from C to B is not the main goal of its push regarding compliance. It requires leaving the zone (and metrics) of private corporate governance in the direction of A, thereby accepting public-regarding responsibilities.[29]

There is general agreement about the basic structures of good compliance.[30] The common framework includes (1) a commitment from senior leadership to the task, setting a right "tone at the top;"[31] (2) delegation of authority to officials with distinct compliance responsibilities and the resources to do their task; (3) firm-wide education and training about both the substance and process of compliance; (4) informational mechanisms to alert as to suspicious activity (e.g., whistleblowing procedures); (5) audit and surveillance tactics to detect compliance failures or risks; and (6) internal investigation, response, discipline and remediation so as to learn and adjust when failures occur. By most accounts, the right mix of these is firm-specific, a customization that recognizes the great range of motives, opportunities and types of violations most likely to be a problem at a given firm.

If faced with a heightened de facto or de jure compliance requirement, a rational corporation will revise its risk estimate and respond accordingly. Happily for society, an additional investment in compliance should have the desired effect of raising the level of compliance without the direct expenditure of additional public resources, because the company pays directly, not the government. This outsourcing of costs is part of the policy allure of mandatory compliance. But we can't really count on net improvement because will still don't know enough about what works, and at what aggregate of direct and indirect costs. Recall the compliance officer's lament with which we began. Marginal value is hard to measure, and these steps can be very burdensome. Enforcers are not constrained by cost-benefit mandates or much else in the way of formal accountability that would discipline their demands.[32] What they choose might work, but we have

[29] See Griffith, supra, at 2124.
[30] Practice-oriented treatises on compliance, with thorough discussions of these features, include JEFFREY KAPLAN & JOSEPH E. MURPHY, COMPLIANCE PROGRAMS AND THE ORGANIZATIONAL SENTENCING GUIDELINES (2015 ed.) and JED S. RAKOFF & JONATHAN SACK, FEDERAL CORPORATE SENTENCING: COMPLIANCE AND MEDIATION (2016).
[31] This is via formal codes of conduct or statements of principles, and by modelling of those behaviors in senior executives' day-to-day behaviors.
[32] See Griffith, supra, at 2118-20.

little in the way of evidence to instill confidence. Instead, we might just be getting costly symbolism.

This ambiguity is crucial to all that follows. A, B and C were presented as if they were concrete and knowable reference points, but that is surely not true. Each is imaginary and socially constructed. The lens through which this social construction occurs inside any given firm is a mix of individual cognition and corporate culture, bringing us to the topic at hand.

B. The Road to Culture

As we saw, the genesis for a compliance obligation in criminal law starts with *respondeat superior* or something closely akin to it, so that a corporation faces liability for unlawful managerial or employee behavior. This is not just the threat of criminal prosecution—firms faced a wide array of civil sanctions and collateral consequences as well, under a host of different federal and state mandates. As the administrative state grew, so did the need for prevention. In some fields (like securities regulation), statutes or rules impose duties to monitor or supervise, thereby making compliance an affirmative legal obligation.[33] Episodic corporate scandals in last half of the last century made the need for compliance more salient, and law-makers reacted accordingly.

The growing pressure to upgrade corporate compliance programs was famously boosted by two developments in the 1990s. The more important, no doubt, was the adoption of the federal Organizational Sentencing Guidelines (OSG), under which the amount of a corporation's criminal fine would vary based on a variety of factors, including the quality of its compliance program.[34] Failure to have state of the art compliance, then, became a distinct legal risk factor. The other was the Delaware Chancery Court's *Caremark* decision,[35] which held that a board of directors' fiduciary duty of care included compliance oversight and monitoring not limited to reacting to problems staring the board in the face. This

[33] See Fanto, supra, at 1132-43 (describing the supervisory mechanisms for broker-dealers and investment advisers required under the securities laws); pp. ---- infra.

[34] While no doubt having a powerful impact on corporate behavior, whether the OSG have achieved their original purpose is controversial. See generally Jennifer Arlen, *The Failure of the Organizational Sentencing Guidelines*, 66 U. Miami L. Rev. 321 (2012).

[35] In re Caremark Int'l Deriv. Litig., 698 A.2d 959 (Del. Ch. 1996). In such cases, plaintiffs would claim that the board of directors failed to prevent some violation of law for which the company suffered large criminal or civil penalties and other harms. For doubts about law-enforced compliance obligations within corporate governance, see Stephen Bainbridge, Caremark *and Enterprise Risk Management*, 34 J. Corp. L. 967 (2006).

is often given credit for hastening the move to more intensive compliance programs, though perhaps hobbled by the ultimate holding in the case that only a "sustained and systematic indifference" to compliance would actually generate liability for individual board members.[36]

Most accounts of this development in the law agree that all this prompted greater compliance effort in corporations. The academic commentary of the time, however, was still skeptical about quality.[37] *Caremark's* "just do something" message invited a check-the-box mentality, and it was unclear that the OSGs insisted on much more than a paper program (or at least that judges had the capacity or motivation to distinguish between state of the art paper programs and high-quality ones). To use Kim Krawiec's description, the standard compliance system might still largely be cosmetic, just to satisfy minimum standards and get sanction credit if needed.[38] This is troubling, obviously, because if credit is given simply for paper compliance, the deterrence calculus is skewed in the wrong direction. It is possible that these academics were being too harsh, and that progress was being made toward better compliance. Practitioners seemed to think so,[39] though perhaps moved by the recognition that this was becoming a lucrative practice area. We lacked the data to know for sure one way or the other.

At roughly this same time, academic research drawing from social psychology and organizational behavior exploded in volume and visibility, producing a growing stream of evidence-based inferences of the sort that had theretofore been lacking about "what works and what hurts"[40] in compliance. It came with a substantive message. Prominent researchers in the field became insistent that without a values or ethics base to crowd out excess legalism in compliance, compliance programs would predictably fall short.[41] By the end of the last century, the role of culture in compliance had gained solid academic acceptance.

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[36] The standard is one of bad faith, not an easy thing for plaintiffs to show. See Stone v. Ritter, 911 A.2d 362 (Del. 2006).

[37] See William Laufer, *Corporate Liability, Risk Shifting and the Paradox of Compliance*, 54 Vand. L. Rev. 1343 (1999).

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

[39] See Harvey Pitt & Karl Groskaufmanis, *Minimizing Corporate Criminal and Civil Responsibility: A Second Look at Corporate Codes of Conduct*, 78 Geo. L.J. 1559 (1990).

[40] See Linda Klebe Treviño et al., *Managing Ethics and Legal Compliance: What Works and What Hurts?*, 41 Cal. Mgt. Rev. 131, 146 (1999)..

[41] Lynn S. Paine, *Managing for Organizational Integrity*, Harv. Bus. Rev. (March-April 1994); For early legal discussions following up on the suggestions of values-based proponents, see Donald C. Langevoort, *Monitoring: The Behavioral Economics of Corporate Compliance with Law*, 2002 Colum. Bus. L. Rev. 71; Milton C. Regan, Jr., *Moral Intuitions and Organizational Culture*, 51 St. Louis U.L.J. 941 (2007); John Hasnas, *Managing the Risks of Legal Compliance: Conflicting Demands of Law and Ethics*, 39 Loyola (Chi.) L.J. 507 (2008).

The parade of corporate wrongdoing became all the more garish. The bursting of the technology bubble in 2000 and the spate of financial accounting scandals exposed in its wake—Enron and WorldCom most notoriously,[42] though hardly alone—offered dramatic evidence of sustained corporate misbehavior. So once again, there were reforms to push in the direction of better compliance, most notably in the Sarbanes-Oxley Act of 2002 for publicly-traded corporations. The new public company responsibilities included having systems of internal control over both financial reporting and disclosure generally that were well-designed, tested and audited.[43] Given the close connection between disclosure obligations and the risk of illegality,[44] these reforms added to the compliance pressures. In turn, "tone at the top" and other invocations of ethical culture by regulators were becoming more common.[45] A key step here occurred in 2004, when the OSG were amended to make attention to ethics and culture an explicit compliance goal (firms are expected to "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law"[46]). By this time, more and more companies now had a Chief Ethics and Compliance Officer (CECO), separate and apart from their Chief Legal Officer.[47]

Much more could be (and has been) said about this recent history, the details of which I leave to others.[48] Yet again, events put compliance in a bad light. The global financial crisis that began in 2007 raised new doubts about corporate respect for law, especially in the financial sector.[49] The crisis was barely over when came the LIBOR rate-rigging scandal,[50] and J.P. Morgan's London Whale fiasco.[51] From outside of financial services, there was General

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[42] See Ronald Sims & Johannes Brinkmann, *Enron Ethics (Or Culture Matters More Than Codes)*, 45 J. Bus. Ethics 243 (2003).

[43] See Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 Mich. L. Rev. 1817, 1826-28 (2007).

[44] See Hillary A. Sale & Donald C. Langevoort, *"We Believe:"* Omnicare, *Legal Risk Disclosure and Corporate Governance*, Duke L.J. (forthcoming 2016).

[45] Stephen M. Cutler, SEC Director of Enforcement, *Tone at the Top: Getting it Right*, available at https://www.sec.gov/news/speech/spch120304smc.htm (Dec. 3, 2004).

[46] U.S. SENTENCING GUIDELINES MANUAL sec. 8B2.1(a-b). The OSG Advisory Committee, which set this process of accounting for culture in motion, cautioned against putting too much emphasis on *judging* culture. See David Hess, *Ethical Infrastructure and Evidence-based Corporate Compliance and Ethics Programs: Policy Implications from Empirical Evidence*, 12 NYU J. L. & Bus. 317, 335-36 (2016).

[47] See, e.g., DeStefano, supra.

[48] See Hess, supra, for a good recounting of the recent history.

[49] See CLAIRE A. HILL & RICHARD W. PAINTER, BETTER BANKERS, BETTER BANKS ch. 3 (2015); Michelle M. Harner, *Barriers to Effective Risk Management*, 40 Seton Hall L. Rev. 1423 (2010).

[50] See Alan D. Morrison & Joel Shapiro, *Governance and Culture in the Banking Sector*, Feb. 2016, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2731357.

[51] See Hillary A. Sale, *J.P. Morgan: An Anatomy of Corporate Publicness*, 79 Brook. L. Rev. 1629 (2014); Jill Fisch, *The Mess at Morgan: Risks, Incentives and Shareholder Empowerment*, 83 U. Cinn. L. Rev. 651 (2015).

Motors concealment of ignition switch problems[52] and Volkswagen's emission testing fraud, with the latter showing that disdain for compliance was not a uniquely American phenomenon.[53] Perhaps there really was something in corporate water-fountains to inspire malice and blind corporate agents to common ethical decency.[54]

By this time, regulators and enforcers were willing to take culture head on, so that culture expanded from an academic obsession to a regulatory one. References to culture appeared more and more frequently in official speeches and testimony. At first this was probably just hortatory, intended for political consumption. To an extent, it probably still is. When aimed at a company without a good one, it's a form of name-calling on behalf of an angry public. But in the last few years the interest has seemingly become more concrete. The DOJ now explicitly invokes culture in its guidance about prosecutorial discretion.[55] The SEC and banking agencies have explicitly taken on culture as well, for both enforcement and regulatory supervision.[56] The major self-regulator for broker-dealer firms, FINRA, made culture of compliance a specific topic of inquiry in its 2016 examination program for all broker-dealers, essentially requiring that they have a plan for addressing firm-wide ethical issues.[57] Culture of compliance now has an identity of its own, which begs to be taken seriously.[58]

II. UNDERSTANDING CULTURES OF COMPLIANCE AND NONCOMPLIANCE

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52 See Marianne Jennings & Lawrence Trautman, *Ethical Culture and Legal Liability: The GM Switch Crisis and Lessons in Governance*, 22 B.U. J. Sci. & Tech. L. (forthcoming, 2016).

53 See Josephine S. Nelson, *The Criminal Bug: Volkswagen's Middle Management*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2767255 (April 19, 2016).

54 E.g., Muel Kaptein, *Understanding Unethical Behavior by Unraveling Ethical Culture*, 64 Hum. Rel. 853 (2011).

55 See, e.g., Remarks by Assistant Attorney General for the Criminal Division Leslie R. Caldwell at the 22nd Annual SIFMA Ethics and Compliance Conference, Oct. 1 2014, available at. https://www.justice.gov/opa/speech/remarks-assistant-attorney-general-criminal-division-leslie-r-caldwell-22nd-annual-ethics.

56 In banking, see Alberto Musalem, N.Y. Federal Reserve Board, *Why Focus on Culture?*, available at https://www.newyorkfed.org/newsevents/speeches/2015/mus151123; Baxter, supra; Anjan Thakor, *Corporate Culture in Banking*, 22 Econ. Pol'y Rev. 5 (2016). At the SEC, see Commissioner Luis Aguilar, *Doing the Right Thing: Compliance that Works for Investors*, available at https://www.sec.gov/News/Speech/Detail/Speech/1365171515784 (April 18, 2013).

57 FINRA, *Establishing, Communicating and Implementing Cultural Values*, available at http://www.finra.org/industry/establishing-communicating-and-implementing-cultural-values (Feb. 2016).

58 For an important step in this direction directed at financial institutions, see John M. Conley & Cynthia A. Williams, *The Social Reform of Banking*, 39 J. Corp. L. 101 (2014).

Culture of compliance refers to the shared beliefs—"sense-making"[59]—inside any given organization about the importance or legitimacy of legal compliance vis-à-vis other pressures and goals. It is highly normative. This is in contrast to places where the word is used more loosely—for instance, it's common to hear that a new boss came in and "changed the culture" in his or her sphere of authority. If all the boss did was to threaten wholesale firings, behavior may have changed in a way that involved raw fear, but without altering the prevailing belief system. Cultural change may follow or not, and if it does, not necessarily for the better. Cultures based on intimidation are not a particularly good route to either honesty or accountability. (The same point might be made about firms threatened with prosecution or civil enforcement).

Culture becomes especially important, then, when—as is often the case—the structural aspects of compliance and supervision cannot or do not otherwise influence behavior. Control structures are costly and intrusive in many different ways, such that there are limits on what firms will spend on them and thus their reach. Culture is what managers and other employees take for granted even when acting in the dark, outside the monitors' line of sight.

An ideal culture of compliance would be one that accepts public responsibility to lessen the net social costs of its activities—the harms from legal wrongdoing—even if a private calculus of likely consequences suggests that there is money to be made by cautious cheating. Using the typology set out in the previous section, in other words, a healthy culture of compliance legitimizes (rather than denigrates) the effort to move C past B and closer to A. What regulators are saying in emphasizing culture is that the credit a company gets depends not only on the structural elements of compliance best practices, but how willingly and well "it" commits to a greater level of precaution and law-abidingness than is crudely rational from a cost-benefit perspective.

As we are about to see, a fair number of anthropologists, sociologists and social psychologists believe that this idealistic sounding effort to instill a responsible, pro-social corporate culture is possible and worthwhile, if not easy. By contrast, orthodox economists' heads practically explode at the thought. Behaviors matter, not beliefs. If B is optimal, there is no reason to seek A, and

[59] See generally KARL WEICK, SENSE MAKING IN ORGANIZATIONS (1995). The study of organizational culture generally is a massive scholarly field still working through the numerous interdisciplinary challenges of defining culture, discovering its antecedents, and assessing its consequences. See Charles A. O'Reilly et al., *The Promise and Problems of Organizational Culture: CEO Personality, Culture and Firm Performance*, 39 Group & Org. Mgt. 595 (2014). The long-standing methodological rift between sociologists who focus on culture and psychologists who focus on individual cognition has hardly been resolved, notwithstanding much effort at reconciliation.

marketplace discipline of various sorts threatens those misguided enough to try. Businesses are inclined to aggression and risk-taking in the name of survival and profit, normalizing within the internal belief system what outsiders might view as unethical opportunism, i.e., "self-interest seeking with guile."[60] These economists would characterize the effort to instill a pro-social corporate culture as hopelessly naïve, maybe even illegitimate. And if everything is coldly calculative, the only solution is to change the calculus in favor of more enforcement and greater sanctions, not prattle on about ethics and social responsibility.

The next portion of this article will travel across this methodological and normative quicksand to try to answer some important questions about instilling cultures of compliance. But first we have to set forth the hopeful case for building pro-social corporate cultures.

A. Pro-Sociality

Outside of orthodox economics there is a strong belief that human and organizational motivations are complicated, with the capacity to be better than the "homo economicus" prediction of relentless self-interest indicates. In these accounts, calculativeness gives way to the power of identity and beliefs—including the pull of pro-social behavior like cooperation and loyalty—that vary in intensity and direction but can be harnessed for the good. There are ethical cultures and climates, and unethical ones.[61] We just need more of the former.

As Lynn Stout and other legal scholars have argued with respect to corporations and other economic settings,[62] there is substantial evidence in the social sciences (and natural sciences) of strong moral impulses. One of the important findings of psychological research in behavioral ethics, for example, is that the incidence of cheating in experimental settings is noticeably lower than it could be even in situations where there is little or no likelihood of detection, and that certain pro-social interventions can nudge subjects toward good behavior

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[60] This famous phrase from Oliver Williamson is often used to describe the methodological assumption that natural human behavior is both self-serving and clever. See Oliver E. Williamson, *Opportunism and its Critics*, 14 Manag. & Dec. Econ. 97 (1993).

[61] For a good literature review with extensive citations, see Linda Klebe Treviño et al., *(Un)Ethical Behavior in Organizations*, 65 Ann. Rev. Psych. 635 (2014). Brian Galle has found evidence of substantial compliant behavior among certain non-profit private foundations without much of any threat of enforcement. *Corporate Compliance without Enforcement? Private Foundations and the Uniform Prudent Management of Institutional Funds Act*, May 3, 2016.

[62] See, e.g., LYNN STOUT, CULTIVATING CONSCIENCE: HOW GOOD LAWS MAKE GOOD PEOPLE (2011).

without material incentive. Out of this hopefulness has come a genuine enthusiasm among many behavioral types that well-designed "values-based" ethics and compliance programs can succeed, with careful nurturing.

Recently in this journal, Gary Weaver (a leading organizational behaviorist) drew a helpful map for what a values-based approach should seek to do, and offered evidence to show that it works better than a command-focused approach.[63] He stresses strong ethical leadership at the top (and among supervisors throughout the firm) so that leaders "(a) are trustworthy; (b) are fair and balanced in decisions; (c) set ethical examples in the workplace; (d) conduct their personal lives in an ethical manner; (e) listen to employees; (f) discipline employees who violate ethical standards; (g) keep employees' best interests in mind; (h) initiate discussion of ethics with employees; (i) openly incorporate ethical considerations into decision making; and (j) assess success not just in terms of results but according to how those results were obtained."[64] In an adjacent contribution, Tom Tyler added to this list an emphasis on the power and inherent legitimacy of both organizational and legal commands in motivating compliant behavior without threats or force.[65]

There is now a lively and sophisticated literature by academics and a few practicing lawyers promoting this kind of values-based, anti-command and control mission.[66] Building on the inclination toward pro-social behavior, they say, firms should make a deep commitment to both law and ethics, and work hard to sustain that commitment against conflicts of interest and other temptations. They urge companies to commit to a compliance program not limited to simple law-abidingness but to doing the right thing as a matter of Aristotelian habit formation and sustainable corporate identity. Boards and senior managers have to become evangelists for virtue, and persistently both model and communicate the importance of that commitment against internal and outside pressures to the contrary.

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[63] Gary R. Weaver, *Encouraging Ethics in Organizations: A Review of Some Key Research Findings*, 51 Am. Crim. L. Rev. 293 (2014).
[64] Id. at 309, citing Michael E. Brown et al., *Ethical Leadership: A Social Learning Perspective for Construct Development and Testing*, 97 Org. Behav. & Human Dec. Processes 117 (2005).
[65] Tom R. Tyler, *Reducing Corporate Criminality: The Role of Values*, 51 Am. Crim. L. Rev. 267 (2014). Tyler is one of the country's most prominent social psychologists and a pioneer in promoting equity-based workplace behaviors as key to good organizational conduct.
[66] E.g., Dan Awrey et al., *Between Law and Markets: Is There a Role for Culture and Ethics in Financial Regulation?,* 38 Del. J. Corp. L. 191 (2013); Hess, supra; Fanto, supra; Stucke, supra. From a practice perspective, see Scott Killingsworth, *Modeling the Message: Communicating Compliance through Organizational Values and Culture*, 25 Geo. J. Leg. Ethics 961 (2012). EthicalSystems.org is an organization headed by prominent social psychologist Jonathan Haidt to promote research on corporate ethics and behaviorally-informed interventions therein. See http://www.ethicalsystems.org/.

As noted earlier, the prominence of the rosy side of behavior ethics research came at about the same time prosecutors and regulators started talking more seriously about the culture of compliance. This is not necessarily a claim that this new-found interest was *because* of this academic research. Frustration and continuing public discourse about corporate greed and irresponsibility no doubt led to the growing obsession with culture, but the academic connection should not be dismissed entirely.

B. Assessing the Claims

The foregoing case for optimism about corporate cultural change has a solid academic pedigree. But it reads as something of a half-truth, because there is a darker set of findings that comes out of the same behavioral ethics and other contemporary social sciences research. More pessimistically, this work makes a case for the presence of pervasively rationalized self-interest in corporate culture, rather than natural goodness waiting to be unlocked. This darker scholarly account has roots in the white collar crime literature in sociology, which has long been interested in the pathologies of business organizations.[67] Relatively more recent is a growing body of experimental psychological research on ethics, plus work connecting individual and group cognitions to organizational cultures. The bottom line in behavioral ethics is that there may be less cheating and opportunism than there could be (as noted above), but still much more than there should be. The challenge is to explain how and why.

This is not a reversion to assumptions of neoclassical economics by any means, even though some of the implications may point in the same direction. Indeed, much of contemporary economics now relaxes the rationality and self-interest assumptions, willing to acknowledge that human motivations are complex, often pro-social and cooperative, and highly cultural. Beliefs matter, as do identities.[68] There is ample empirical evidence that strong corporate cultures can add economic value, and are recognized as valuable assets by firm leaders.[69] But self-interest hides, not disappears, and internal loyalty and bonding can

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[67] A classic study in this genre is ROBERT JACKALL, MORAL MAZES: THE WORLD OF CORPORATE MANAGERS (1983).
[68] See George Akerlof & Rachel Kranton, *Identity and the Economics of Organizations*, 19 J. Econ. Persp. 9 (2005).
[69] John R. Graham et al., *Corporate Culture: Evidence from the Field*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2805602 (July 7, 2016); Luigi Guiso et al., *The Value of Corporate Culture*, 117 J. Fin. Econ. 60 (2015).

palpably increase the level of aggression directed at outsiders (e.g., customers, competitors), even as it greases internal trust and cohesion.[70] Cultural and situational pressures cause bad behavior even among good people.

While laboratory experiments are the source of much of this new learning, some of the most helpful research on corporate culture seeks out correlations in large data sets between observable executive personality or cultural traits and firm-wide outcomes. The Ashley Madison study is an example of such work by financial economists, seeing if there is a link between the tendency to cheat in an executive's personal life and outcomes both good and bad: innovation on one hand, fraud liability on the other. Other recent papers in this genre find positive correlations between personal managerial shortcomings regarding substance abuse, domestic violence, etc. and firm-level financial improprieties,[71] and between one form of misconduct (options backdating) and the likelihood of other unrelated compliance violations.[72] They find that character and culture both matter. They also stress that the antecedents of wrongdoing spread like viruses from firm to firm, via geographic connections and social networks.[73] Corporate cultures are never entirely insular.

This empirical interest in firm-level wrongdoing is important. The rational actor model held primacy for so long in the business context, even in the face of psychology research suggesting that people actually think and behave quite differently, largely because corporate managers seemed to have such strong incentives to be smart rather than fall prey to heuristics and biases. In a competitive selection process, the smart should be rewarded. Smart and unbiased (or rational) were thus assumed to be synonymous. Yet the financial economics research was showing that variable managerial traits, personalities, beliefs and the like had persistent effects even in the most successful firms. Psychology matters. That prompted behavioral economists to take on the question of whether there might not be adaptive biases: beliefs and cultures that are not entirely realistic, but promote successful economic behavior nonetheless.

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[70] E.g., John Hildreth et al., *Blind Loyalty? When Group Loyalty Makes Us See Evil or Engage in It*, 132 Org. Behav. & Hum. Dec. Processes 16 (2016). On how individual and cultural impulses connect, see Jesse Kluver et al., *Behavioral Ethics for Homo Economicus, Homo Heuristicus, and Homo Duplex*, 123 Org. Behav. & Hum. Dec. Processes 150 (2014).

[71] Robert H. Davidson et al., *Executives Off-the-Job Behavior, Corporate Culture and Financial Reporting Risk*, 117 J. Fin. Econ. 5 (2015). Another study found that a greater incidence of unrelated regulatory violations (an indicator of a weak compliance culture) was also associated with financial misreporting. Simi Kedia, et al., *Culture of Weak Compliance and Financial Reporting Risk*, available at http://www.ivey.uwo.ca/cmsmedia/2077220/01-29-kedia.pdf.

[72] See Lee Biggerstaff et al., *Suspect CEOs, Unethical Culture, and Corporate Misbehavior*, 117 J. Fin. Econ. 98 (2015).

[73] See Christopher Parsons et al., *The Geography of Financial Misconduct*, available at http://www.nber.org/papers/w20347.pdf.

Today, the best-known examples of adaptive biases in economics and psychology have to do with optimism and overconfidence.[74] In a highly uncertain environment, anxiety is natural. But both personally and organizationally, anxiety is problematic—distracting and potentially demoralizing. It would follow that a moderately unrealistic level of optimism and overconfidence might reduce anxiety and lead to greater effort and persistence, among other things. If all this is right (and a long-standing research program in social psychology suggests so), we might predict that leaders would be chosen for such traits, and in turn would try to instill comparable beliefs in the company culture. Today, as a result of research in organizational behavior, social psychology and financial economics, significant evidence suggests that this is so.[75]

In turn, these biases matter to corporate governance and compliance.[76] If executives are overconfident, for instance, they are likely to take more risks (and be rewarded, on average, for so doing[77]). All the more so if their excessively positive beliefs are viral and internalized company-wide. This risk-taking could relate to law, especially where the law is somewhat ambiguous. Where the law calls for an assessment of the situation—whether in tort law's approach to negligence, or securities law's requirement that management analyze accurately the risks and uncertainties it currently faces—such managers and their firms may well fail to calibrate the way the law would want. The cure, if there is one (and it is deemed acceptable) is corporate governance at the top, compliance all the way down. And governance and compliance people would have to be behaviorally adept for the cure to work.

Over-optimism and overconfidence, however, are just two biases that may have survival power within firms. There are many more. If culture matters as much as researchers suggest, such adaptive beliefs and routines extend beyond any one person, becoming the grease that make competitive firms particularly high-performing, instilling a positive and positive sense of power and identity.[78] In the face of such a machine, ethics and compliance have their work cut out.

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[74] I have written about this for some time. See SELLING HOPE, SELLING RISK, supra, at 26-27, 38-40; Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms),* 146 U. Pa. L. Rev. 101, 139-43 (1997).

[75] E.g.,David Hirshleifer et al., *Are Overconfident CEOs Better Innovators?,* 67 J. Fin. 1457 (2012).

[76] See Suman Banerjee, *Restraining Overconfident CEOs via Corporate Governance: Evidence form the Sarbanes-Oxley Act*, 28 Rev. Fin. Stud. 2812 (2015).

[77] See Anand Goel & Anjan Thakor, *Overconfidence, CEO Selection and Corporate Governance*, 63 J. Fin. 2737 (2008).

[78] See Donald C. Langevoort, *Opening the Black Box of Corporate Culture in Law and Economics*, 162 J. Inst. & Theoretical. Econ. 80 (2006).

This grease in the machine is what ethics and compliance programs have to worry about.

III. CULTURAL RESISTANCE

A. Self-Serving Biases at Work

To repeat: a capsule summary of contemporary research on behavioral ethics is that in the face of temptations to cheat, most human beings cheat less than they could, but more than they should. That is to say, orthodox economists are wrong to say that people generally just maximize self-interest by trading off the risks and benefits of opportunism. Conscience and a deep-seated desire for a positive identity and a good reputation really are powerful. On the other hand, opportunism seems to be commonplace when people can rationalize self-interest so as to create consistency between the opportunism and a good self-image. The question—crucial for behaviorally-adept compliance—is what conditions nudge people (or organizations) in one direction or the other.[79]

Keep in mind that self-interest plays out in two overlapping ways. The first involves wrongdoing by a corporate agent that is personally self-serving (e.g., to get a bonus, or avoid being fired), maybe violation of the firm's policies and expectations. Insider trading is a good example of behavior for which the employer faces only a small risk of secondary liability because of the entirely self-serving nature of the act; as a result, regulators have to demand that employers where there is a particularly high risk of insider trading (broker-dealers and investment advisers) adopt policies and procedures to generate compliance. Some cultures bolster this sort of selfishness,[80] pushing point C in our schema in the wrong direction, far away from A and even B.

The other category is where the manager or employee seeks to benefit the firm by his or her unlawful actions.[81] A bribe to get additional business is an example. Here, the legal risk to the firm goes up, but so presumably do the

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[79] For a good overview of behavioral ethics, see Max Bazerman & Francesca Gino, *Behavioral Ethics: Toward a Deeper Understanding of Moral Judgment and Dishonesty*, 8 Ann. Rev. L. & Soc. Sci. 85 (2012).

[80] See Biggerstaff, supra.

[81] Of course, personal benefit often follows from actions taken to benefit the firm. In all likelihood, separating the loyal from the selfish is impossible, since loyalty is often rewarded.

benefits of engaging in the wrongdoing and not getting caught, or getting caught but let off relatively easily. (Recall the suboptimal sanctions under the Foreign Corrupt Practices Act.) In calculative terms, then, this kind of managerial or employee behavior is more complicated and interesting. Especially after the financial crisis, a common observation is that occasional sanctions were simply a cost of doing business and treated as such regardless of the size and presence of an in-house compliance team. The watchdogs bark but don't bite, unless the wrongdoing falls largely into our first category or some scapegoat is needed. Both of these forms of opportunistic law-breaking are relevant to compliance, but the second may actually be the more pernicious in terms of organizational culture because the behavior—though legally risky—is an expression of group loyalty.[82]

There are moral instincts, including the desire in most to be and be seen as a "good" person. At the same time, selfish instincts—presumably also related to survival in evolutionary terms—operate unconsciously but with considerable cognitive effect. Advances in neuroscience shed new light on the contest between the "wants" operating automatically in the brain, and the "shoulds" that happen via a slower, more deliberative effort. The result is a constant struggle for most people, with wants having the upper hand because they process faster. Experimental evidence, for example, suggests that people will often cheat, but stop before the cheating is so egregious that they would have to see themselves as cheaters.[83] Short of that, they rationalize, normalize and avoid so as to maintain cognitive consistency between the actions (self-serving) and their preferred identity (a good person). For better or worse, the mind is adept at facilitating the hypocrisy. All though there is much at work here, and very much still not well understood, there is a sizeable body of research, experimental and in the field, supporting the strong tendency toward "motivated reasoning" (or selective perception), which quite simply is the tendency to interpret what we see the way we want to see it, ignoring or dismissing more threatening implications. This can occur completely out of consciousness, or via more familiar forms of rationalization. It is easiest—with the most "wiggle-room"[84]—when the cues are somewhat ambiguous.[85]

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[82] See Hildreth, supra.

[83] This is a main theme in Dan Ariely's work. See DAN ARIELY, THE (HONEST) TRUTH ABOUT DISHONESTY (2012).

[84] See Jason Dana et al., *Exploiting Moral Wiggle-room: Experiments Demonstrating the Illusory Preference for Fairness*, 33 Econ. Theory 67 (2007).

[85] For a thorough discussion, see Yuval Feldman, *Behavioral Ethics Meets Behavioral Law and Economics*, in EYAL ZAMIR & DORON TEICHMAN, EDS., OXFORD HANDBOOK OF BEHAVIORAL ECONOMICS AND THE LAW (2014).

This is a vast subject, the subject recently of numerous well-publicized books by the psychologists doing this kind of work.[86] Legal scholars in a variety of fields have put these findings to use, including how they relate to compliance, so there is no need to treat the subject at length here.[87] The power of motivated reasoning can be strong, and ample field research indicates that it operates as powerfully, if not more, in settings dominated by sophisticated actors—medicine, finance, etc. Presumably, it has many of the same survival attributes as overconfidence or over-optimism, maintaining focus and persistence, overcoming risk aversion. The effect is clear enough: pursuit of self-interest becomes all the easier, without any threat to positive identity. Ethical lines fade or blur.

This fading is bolstered by a cluster of cognitive traits that operates similarly, under the heading of competitive arousal. Competition and rivalry have a number of motivating effects, leading to greater aggressiveness and risk-taking. (Overconfidence is part of this cluster.) Unfortunately, that kind of hormone-driven arousal also leads to a higher rate of noncompliance and unethical behavior, whether directed against the rival or some third-party.[88]

There is also what goes under the heading of loss aversion or (usefully, I think) "hypermotivation." Aggressive risk-taking comes most strongly when the person or group faces what they perceive as a risk of loss, as opposed simply to the possibility of gain. The mind is highly possessive—it fights particularly hard to keep what it sees as rightfully belonging to it, even if the sense of possession is aspiration or expectation. As the two researchers who coined the term put it, "a wide range of evidence suggests that people who find themselves 'in a hole' and believe that dishonest behavior is the only apparent means of escape are more likely to cheat, steal and lie"[89]—without necessarily acknowledging to themselves that what they are doing is wrong. In business settings, there are many competitive threats that project a strong loss frame.[90]

These are all descriptions of individual cognitions, not cultures. At the organizational level, however, we would expect to see these same biases strengthened and compounded unless there is some potent intervention to check

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[86] E.g., MAX BAZERMAN & ANN TENBRUNSEL, BLIND SPOTS: WHY WE FAIL TO DO WHAT'S RIGHT AND WHAT TO DO ABOUT IT (2011); ARIELY, supra.

[87] See, e.g., Donald C. Langevoort, *Behavioral Ethics, Behavioral Compliance*, in ARLEN, ED., supra; Killingsworth, supra; Regan,, supra; see also Milton C. Regan, Jr., *Risky Business*, 94 Geo. L.J. 1957 (2006)..

[88] E.g., Mina Cikara et al., *Their pain gives us pleasure: How intergroup dynamics shape empathic failures and counter-empathic responses*, 55 J. Exp. Soc. Psych.110 (2014); Jason Pierce et al., *From Glue to Gasoline: How Competition Turns Perspective Takers Unethical*, 20 Psych. Sci. 1 (2014).

[89] Scott Rick & George Loewenstein, *Hypermotivation*, 45 J. Mktg. Res. 645 (2008).

[90] See Greve et al., supra, at 64-67 (competitive strain as a source of corporate misconduct).

them (i.e. governance or compliance). Groups are more powerful than any one person, with their own claims to loyalty and identity.[91] Confidence, motivated inference and other biases become all the more adaptive when mutually reinforced.[92]

And that is compliance's problem. The next section will turn to particular forms of self-serving inference about the law. For now, see how unlikely it is that communications and training about ethics will survive the filtration process imposed by deeply functional beliefs that rationalize and facilitate aggression and risk-taking in competitive settings. To return for a moment to the individual focus, work in behavioral ethics studies experimental settings where the incidence of cheating rises or falls. It falls under some conditions, including prompting the conscious realization that what the subject is facing is a moral choice. So far, so good. The conditions under which the incidence of cheating rises, on the other hand, under many conditions that are highly descriptive of business settings. Competitive arousal is one, stress and "depletion" others.[93] Visible trappings of wealth make cheating more likely,[94] as do competitive reward systems: one research paper speaks of "goals gone wild."[95]

In other words, business settings that are perceived as highly competitive are riddled with prompts that facilitate unconscious cultural resistance to the implications of any strong emphasis on ethics and compliance. After all, the goal of compliance and ethics is to teach people to leave money on the table where an opportunity comes with enough moral or legal risk. The compliance instinct is to err on the side of caution. But that runs counter to what is often hard-wired into the organization psyche, upsetting the norms and customs on which many successful businesses think they depend.[96]

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[91] See Alain Cohn et al., *Business Culture and Dishonesty in the Banking Industry*, 516 Nature 86 (2014); Akerlof & Kranton, supra.

[92] See generally Langevoort, *Black Box, supra.* A strand of the literature on corporate culture speaks in evolutionary terms: cultures that facilitate corporate survival. See J. Richard Harrison & Glenn Carroll, *Organizational Demography and Culture: Insights from a Formal Model and Simulation*, 43 Admin. Sci. Q. 511 (1998).

[93] David Walsh & Lisa Ordóñez, *The Dark Side of Consecutive High Performance Goals: Linking Goal Setting, Depletion and Unethical Behavior*, 121 Org. Behav. & Human Dec. Processes 79 (2014).

[94] See Miryam Kouchaki et al., *Seeing Green: Mere Exposure to Money Triggers a Business Decision Frame and Unethical Outcomes*, 121 Org. Behav. & Hum. Dec. Processes 53 (2013).

[95] Lisa Ordóñez et al., *Goals Gone Wild: The Systematic Side Effects of Overprescribing Goal Setting*, 23 Acad. Mgt. Persp. 82 (2009).

[96] See Langevoort, *Behavioral Ethics*, supra; Scott Killingsworth, *"C" is for Crucible: Behavioral Ethics, Culture and the Board's Role in C-Suite Compliance*, May 29, 2013, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2271840. Antitrust compliance is particularly

The trade-offs are visible enough. Overconfidence, for example, is associated with greater compliance risks but also associated with greater internal motivation and more innovation. It may be a leadership trait. A team of behavioral researchers who focus on financial reporting recently posed the question well: if you could administer shots to senior executives that make them less optimistic—or less focused and intense—would you?[97] It would probably help in terms of compliance and ethics, but might also put organizational success at risk. Recall the Ashley Madison finding that the inclination to cheat is positively associated with firm-level creativity and innovation. Tweak the belief system and the consequences are unpredictable. Fear of the unknown begets anxiety; anxiety triggers resistance.

None of this is a good reason for the government (or the public) not to insist on dampening interventions. Indeed, the Sarbanes-Oxley Act is designed largely to do just that for public companies, through a series of speed bumps in the form of stronger audit committees, more extensive internal controls, and the like.[98] What is more doubtful is the power of the intrinsic—self-regulated—approach to compliance. The behavioral research would predict that most officers and directors would sincerely *intend* to promote legal caution and good ethics, but that the good intentions would be at risk both at the executive level and in the process of cultural translation and diffusion throughout the organizational hierarchy.

All this should not be overstated—corruption is not the norm, and there is considerable force to pro-social impulses. Remember that the rationalization and normalization predicted by the behavioral ethics research is usually within limits. Individuals don't tend to cheat brazenly, not only because of the chance of detection but because that threatens self-image. Presumably, similar restraint exists in the organizational culture, too. Organizational corruption happens, of course, as numerous scandals have shown. But corruption is usually a lengthy slide down a slippery slope,[99] as small transgressions grow larger and larger without being checked early enough either by external sanction or internal governance. There is a cultural dimension to this, as the eminent psychologist

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interesting in that it addresses wrongdoing that diminishes competition, a fairly direct response to feeling an excess of competitive pressure..

[97] Gregory Capps et al., *Natural Optimism in Financial Reporting: A State of Mind*, 30 Acct'g Horizons 79 (2016).

[98] Langevoort, *Sarbanes-Oxley*, supra, at 1828-33.

[99] See Catherine Schrand & Sarah Zechman, *Executive Overconfidence and the Slippery Slope to Financial Misreporting*, 15 J. Acc'g & Econ. 311, 313 (2012)(presenting evidence of innocent, overconfident first steps that eventually lead to violations of law).

John Darley has written,[100] as grosser rationalizations fuel the growing willingness to transgress. By that point, any culture of compliance has been thoroughly defeated. Compliance has better odds when addressing the small steps before the devolution, even if considerable cultural resistance is already in place.

B. Then Why the Optimism?

So a closer reading of the behavioral research on cognition and culture suggests that pro-sociality is not necessarily the natural state in business organizations, and any effort to instill such faces formidable resistance. For example, the bulk of the research on conflicts of interest indicates that conflicts tend to be resolved cognitively (and organizationally) in favor of self-interest. Max Bazerman and colleagues have written extensively about the psychology behind auditors' willingness to abet client misrepresentations, and come to the pessimistic conclusion that independence is cognitively *impossible*. They advocate strong regulatory (not values-based or self-regulatory) solutions.[101]

So are the optimists missing something, or being naïve? I suspect neither, because many of those same proponents are also responsible for many of the darker research findings. They are first-rate academics. They often do acknowledge at some point that the route to exemplary ethics faces these obstacles, just not with the same emphasis. Weaver, for example, spends the large bulk of his attention on building pro-social attitudes in corporate settings, but at the end expresses concerns about the automaticity of self-interest and leaves the balance between these opposing forces as an open research question.[102] Read carefully, they are more making the point that values-based interventions are necessary than that they are sufficient.

Two things are likely going on in the relative optimism with which compliance is promoted, including the values-based framework. First, there is an element (no surprise) of self-interest. Compliance has become a big business, and

[100] John Darley, *The Cognitive and Social Psychology of Contagious Organizational Corruption*, 70 Brook. L. Rev. 1177 (2005); see also Blake Ashford & Vikas Anand, *The Normalization of Corruption in Organizations*, 25 Res. in Org. Behav. 1 (2003).

[101] Don Moore et al., *Conflicts of Interest and the Case of Auditor Independence: Moral Seduction and Strategic Issue Cycling*, 31 Acad. Mgt. Rev. 10 (2006); see also Don Moore & George Loewenstein, *Self-Interest, Automaticity, and the Psychology of Conflict of Interest*, 17 Soc. Justice Res. 189 (2004).

[102] Weaver, supra, at 314-15. Legal scholars and practitioners understand this, too. E.g., Fanto, supra, at 1166 & n. 148; Killingsworth, supra.

experts are in demand. That requires a constructive, positive agenda, because no one pays much just to hear academic doom-saying. So the positive gets accentuated. This is amplified by the growing cadre of compliance consultants and lawyers who specialize in improving compliance. Their business model, too, has to be founded on some display of boosterism about what works in compliance, not what makes it hard. That much is understandable.

The other takes up a point made earlier. There is very little doubt that some (or much) of research in behavioral ethics is ideologically value-laden. The right-leaning tilt of Chicago-school economics sees its opposite in behavioral approaches in the social sciences.[103] Many who do this work acknowledge being deeply troubled by corporate social irresponsibility, workplace inequity, arrogance and greed, and plainly want to change it. (I put myself in that category, by the way.) If so, there is a felt need to accentuate the promise of ethical salvation by good works—to stress *what works*—and not given in to some Calvinist acceptance of the inevitably of corporate sin. We will soon see what happens inside the firm when the ethic and compliance effort comes to be viewed in the corporate culture as the work of missionaries trying to save sinners.

IV. RESISTANCE SCRIPTS

The aim thus far has been to portray compliance as a struggle between pro-sociality and self-interest, which plays out in both individual cognition and behavior and corporate culture. The outcome of this struggle varies from firm to firm and is highly situational. Some cultural traits (e.g., a strong social orientation, or in some settings a more conservative political ideology) may push in the direction of more law-abidingness rather than less. But my general impression leans toward pessimism: selection biases, and the grease of normalization and rationalization, can too easily flourish in the conditions present in so many businesses. This is especially so where those inside the organization feel a sense hyper-competition, i.e., a survival threat. What pro-social ethics and law-abidingness are then up against is daunting. The culture enables beliefs that either suppress the perception of inappropriate ethical and legal behavior in the first place, so that it is not recognized as a problem at all, or justify the behavior to buffer against burdens of guilt and anxiety. As we saw in the last section, these subtle forces allow people and firms to maintain a positive self-image and identity while competing effectively, even viciously. A regulator, enforcer or internal

[103] See RICHARD A. POSNER, BEHAVIORAL LAW AND ECONOMICS: A CRITIQUE (2002).

compliance officer will observe people and groups who seem quite sincere in their intentions to do the right thing, even when they don't.

The opaque visibility (if not invisibility) of culture is a challenge. But sociologists and anthropologists who study cultures have long pointed out the visible markers of culture—myths, totems, ceremonies—that offer a glimpse into the substance and power of prevailing beliefs. Increasingly, they pay attention to these markers in contemporary business organizations.[104] Those interested in compliance should, too. The kind of normalization and rationalization that greases the internal corporate machinery often emerges in the form of schemas and scripts—well-learned and oft-repeated narratives that bolster the legitimacy of what is believed and how business is done.[105] Initiatives to promote better compliance, whether from the inside or the outside, have to recognize them. This section considers a number of common scripts via which the corporate culture deflects legal and ethical demands, thereby impeding the hoped-for journey away from B by blurring, if not denigrating, A.

A. Legal Construal

In an important series of article, alone and with a variety of co-authors, sociologist Lauren Edelman has taken a deep look at businesses internalize beliefs about the meaning of legal demands, particularly equal employment opportunity requirements.[106] Regulators send messages about what the law expects and requires, say, in terms of human resources decisions regarding hiring, promotion and termination. Professional groups within the firm—those charged with these responsibilities—interpret those expectations and requirement in ways that may distort the original message, so that what is internalized is different.[107]

Self-interest plays an important role here, though not a simple one. One of Edelman's important discoveries was that some human resources specialists

[104] A useful description for a legal audience is Greg Urban, *Corporations in the Flow of Culture*, 39 Seattle U. L. Rev. 321 (2016). Appropriate to our interest here, Urban notes how permeable corporate cultures are—and have to be—to the influences of the larger social culture.
[105] See Dennis A. Gioia & Peter Poole, *Scripts in Organizational Behavior*, 9 Acad. Mgt. Rev. 449 (1984).
[106] E.g., Lauren B. Edelman, *Legal Ambiguity and Symbolic Structures: Organizational Mediation of Law*, 97 Am. J. Soc.1531 (1992).
[107] In turn, such organizational construals feed back into the process of law-making. See Lauren B. Edelman & Shauhin Talesh, *To Comply or Not to Comply—That Isn't the Question: How Organizations Construct the Meaning of Compliance*, in CHRISTINE PARKER & VIBKEK NIELSON EDS., EXPLAINING COMPLIANCE: BUSINESS RESPONSES TO REGULATION 103 (2009).

become change agents, advocating for greater attentiveness to new legal demands.[108] Some of this draws from the larger social culture—equal opportunity, for example, deserves respect. This would be an example of pro-sociality at work (moving B closer to A in employment law compliance). But she also notes what economists would call intra-firm rent-seeking behavior: those who are charged with interpreting and applying the law covet more power, influence and resources vis-à-vis others in the firm, and wrapping one's function in the cloak of legal requirement and social expectation is a good way to negotiate.[109] The consequence of new legal demands, often enough, is to empower those who claim the ability to interpret and apply them.

A separate body of research in cognitive psychology adds to this story. Yuval Feldman and various colleagues have, in a variety of experiments and commentaries, observed that the otherwise strong power of the law-abidingness norm diminishes considerably when the law is ambiguous.[110] This is very similar to work in behavioral ethics regarding "moral wiggle-room:"[111] the automaticity of self-interest when the mind can find a way to maintain consistency between the desired self-image as a good person and what is wanted. Legal ambiguity, in other words, enables self-serving scripts that are more easily believed. And as all lawyers know, legal ambiguity is commonplace in regulation.

As Edelman's work stresses, however, self-interest can play out in a number of different ways, bringing us back to the distinction between points B and C. Intra-firm rent-seeking is manifest in C, which we've so far portrayed as regressive. But as she shows, it needn't be: some firm employees' self-interest may be consistent with more legal compliance, not less.

This echoes a long-standing question of interest, to me and many others: are corporate lawyers cognitively (and culturally) inclined toward their own self-interest or toward the interests of their clients? If the former, we might well predict that attorney self-interest is risk-averse, because the blame lawyers receive

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[108] See Lauren Edelman et al.,, *Employers' Handling of Discrimination Complaints: The Transformation of Rights in the Workplace*, 27 Law & Soc'y Rev. 497 (1993); see also Frank Dobbin, et al., *Equal Opportunity Law and the Construction of Internal Labor Markets*, 99 Am. J. Soc. 396 (1993).

[109] See Lauren Edelman & Mark Suchman, *The Legal Environments of Organizations*, 23 Ann. Rev. Soc. 479, 499-500 (1997).

[110] See Yuval Feldman & Henry E. Smith, *Behavioral Equity*, 170 J. Inst. & Theoretical Econ. 137 (2014); Yuval Feldman & Doron Teichman, *Are All Legal Probabilities Created Equal?,* 84 N.Y.U. L. Rev. 980, 995-97 (2009); Yuval Feldman, *Self-Interest and the Ambiguity of Legal Norms: An Experimental Analysis of the Rule versus Standard Dilemma*, 4 Rev. L. & Econ. 81 (2008); Feldman, supra. On the impact of such biases, see Linda Babcock & George Loewenstein, *Explaining Bargaining Impasse: The Role of Self-Serving Biases*, 11 J. Econ. Persp. 109 (1997).

[111] See note --- supra.

if they bless an action later determined to be unlawful is far greater than what they suffer from just saying no to a client. And indeed, that is a stereotype—lawyer as nay-sayer. Excessive legal caution in the face of ambiguity is a way to getting to A, albeit a costly one for the firm and its shareholders.[112]

For a variety of reasons, however, lawyer self-interest and client self-interest are more likely to converge in cognition and corporate culture, so that in-house lawyers, especially, are not particularly reliable enthusiasts for the socially optimal compliance point, even as they pay close attention to legal commands. The interested reader can find much more on this elsewhere,[113] but I would stress two reasons in particular. First, firm leaders (CEOs in particular) have come to understand the costs of nay-saying, and have worked hard to recruit in-house lawyers (and indeed outside lawyers as well) who are especially attuned to business needs. Promotion tournaments inside the company reinforce this, encouraging and rewarding risk-takers, especially when—as is almost always the case—the law is systematically under-enforced. Recent work in financial economics demonstrates that chief legal officers tend toward client interest (or managerial self-interest) when compensated like managers, i.e., with a bundle of incentive payments.[114]

The other reason is epistemological. Lawyers usually have only an indirect view of the myriad facts and circumstances faced by corporate managers and employees on the ground. On most all routine matters, they have to rely on second-hand (or even more remote) assessments of legally crucial inputs like risk, reward, and reasonableness. The more cognitively dependent the lawyer is on in-house personnel, the more likely those inferences are to be biased. When lawyers have successfully been acculturated into the firm, those inferences come easily. (So, too, with compliance personnel, if not walled-off.)

Consider this example from financial services. On matters relating to the suitability and adequacy of risk disclosure in the sale of complicated financial products to customers, informed consent is something of the norm. In most circumstances, neither lawyers nor compliance personnel become intimately

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112 See Donald C. Langevoort & Robert Rasmussen, *Skewing the Results: The Role of Lawyers in Transmitting Legal Rules*, 5 S. Cal. Interdisc. L.J. 375 (1997).

113 See Sung Hui Kim, *Inside Lawyers: Friends or Gatekeepers?*, 84 Fordham L. Rev. 1867 (2016); see also Donald C. Langevoort, *Getting (Too) Comfortable: In-house Lawyers, Enterprise Risk and the Financial Crisis*, 2012 Wisc. L. Rev. 495; Regan, supra.

114 See Adair Morse et al., *Executive Lawyers: Gatekeepers or Totems of Governance?*, J. L. & Econ. (forthcoming, 2017). As to outside counsel, consider the evidence that certain illicit accounting practices spread via law firm connections. See Patricia Dechow & Samuel Tan, *How Do Accounting Practices Spread? An Examination of Law Firm Networks and Stock Option Backdating*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2688434 (Feb. 23, 2016).

involved in the sales interaction, though the latter will certainly see the results within the surveillance system. Has there been informed consent? My sense is that salespeople are cognitively and culturally motivated to see the answer is yes, and in normal circumstances, legal staff will usually leave those fact-specific inferences alone unless and until there is push-back. For a host of practical reasons that were alluded to earlier, push-back is rare. Yet there is a great deal of ambiguity in the law about informed consent, especially with respect to vulnerable investors (e.g., senior citizens) or especially complex products.[115] Whatever messages might be sent about dealing fairly with customers, sales forces can develop strong—and motivated—inclinations to believe that disclosure works, so that otherwise fairly aggressive sales tactics are deemed legitimate and lawful.[116] So can their lawyers.

We have to be careful here, because there is not necessarily any obligation to interpret truly ambiguous laws against self-interest. This is where the line between law and ethics becomes especially important, and motivated inference affects both. Even as to law, my point is that there may well be an inclination to see more ambiguity than there really is, and use that internally as leverage for opportunism. Something has to explain why there are so many fines and penalties imposed on firms that had so many lawyers at their disposal but took the risks anyway.

B. Legitimacy

The pro-social claim for embracing a culture of compliance strongly depends on the belief that law-abidingness is a virtue, rejecting the Holmesian "bad man" approach of a simple risk-return calculus to obeying the law or not.[117] In other words, most people accept the legitimacy of law and want to conform to it, in letter and spirit. And indeed, there is plenty of social science evidence that

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115 See, e.g., JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 1041-54 (7th ed. 2013).

116 See LANGEVOORT, SELLING HOPE, supra, at 133-37. In fact, disclosure will sometimes *increase* opportunism. See George Loewenstein et al., *The Limits of Transparency: Pitfalls and Potential of Disclosing Conflicts of Interest*, 101 Am. Econ. Rev. (Papers and Proceedings) 423 (2011). On the disheartening willingness of some firms in the securities industry to hire financial advisers with questionable disciplinary histories, see Mark Egan et al., *The Market for Financial Adviser Misconduct*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2739170 (2016). On the impact of a sales culture on compliance, see Arthur B. Laby, *Regulatory Convergence and Organizational Culture*, 90 Tulane L. Rev. 1181 (forthcoming, 2016).

117 See Benjamin C. Zipursky, *The Internal Point of View in Law and Ethics: Introduction*, 75 Fordham L. Rev. 1143, 1143-44 (2006)(describing Holmes' contribution).

rates of legal compliance are, generally, higher than what that calculus would predict. [118] But the social science claim is dependent on *whether* the law is viewed as legitimate, and to what extent. Cognition and culture generate answers, which once again may (or may not) be motivated and self-serving. The more cynical about any particular legal mandate a person or group becomes, the less powerful the law's expressive force. Narratives about white collar over-criminalization and prosecutorial overreach feed the de-legitimation.[119]

And so a culture that pushes back against the law in subtle (or not so subtle) ways offers a convenient—and very greasy—script for denigrating A. The storylines come easily, too. We live in a world in which the legislative process is tainted, so that often enough, as public choice theorists predict, law is put up for sale. A company slammed with new regulations can easily construe them as their more powerful competitors' handwork, thus draining the law of all its legitimacy. Other popular tropes with the same effect are to see regulators run amok, mindlessly imposing burdens, or—in a highly polarized political environment—law as the product of partisan advantage. (It is worth noting, for instance, that firms with a Republican orientation are somewhat more likely to be accused of violating labor and civil rights law[120]). When these scripts work, B—not A—claims the mantle of legitimacy.[121]

A classic study in the management literature shows how these kinds of inferences can hobble compliance even when top management wants the compliance.[122] A financial services company was selling insurance policies on

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[118] This is an important theme in the work of social psychologist Tom Tyler. See Tyler, supra, at 268-71. Legitimacy and social license are important in sociological accounts of legal compliance as well. E.g., Jodi Short & Michael Toffel, *Making Self-Regulation More than Merely Symbolic: The Critical Role of the Legal Environment*, 55 Admin. Sci. Q. 361 (2010).

[119] Haugh stresses how easily the rationalizations familiar from the study of white collar crime get put to use in organizations. See Haugh, supra, at 24, citing William J. Stuntz, *The Pathological Politics of Criminal Law*, 100 Mich. L. Rev. 505 (2001). He points out that this process is not fanciful—there may well be criminal excess. Probably so, but our account gives ample reason to suspect that corporate cultures amplify the perception in self-serving ways. This denigration extends beyond any particular law in question, to generalized commitments to law-abidingness. See Janice Nadler, *Flouting the Law*, 83 Texas L. Rev. 1399 (2005).

[120] See Irena Hutton et al., *Political Values, Culture and Corporate Litigation*, 61 Mgt. Sci. 2905 (2015). Democratic-leaning firms are more likely to be accused of securities fraud and intellectual property infringement. Id. On the complicated effects of ideology in taxation, see Bill B. Francis et al., *CEO Political Preference and Corporate Tax Sheltering* (2016), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2762223&download=yes.

[121] On the variability in how key personnel inside firms interpret regulators and their demands—as threats, allies or obstacles—see Garry Gray & Susan Silbey, *Governing Inside the Corporation: Interpreting Regulation and Compliance*, 120 Am. J. Soc. 96 (2014).

[122] Tammy L. MacLean & Michael Benham, *The Dangers of Decoupling: The Relationship Between Compliance Programs, Legitimacy Perceptions and Institutionalized Misconduct*, 52 Acad. Mgt. J. 1499 (2010).

commission, which runs the legal risk that sales agents will "churn" policies—causing households to cancel their existing policy for a new one, just to get another commission. Senior management became aware from regulators that heightened enforcement was likely, and so imposed a new compliance policy: all "substituted" policies within 90 days of cancellation had to be reviewed and specially approved. The sales agents, however, read their own meaning into the message, convinced that management wasn't serious: after all, there had been churning going on previously, for which the salespeople had gotten bonuses and other rewards from the bosses. They construed the message as cosmetic only, encouraging them to do the obvious—churn, but always on the 91st day after cancellation. By the time the law's message reached the field, in other words, it had been hopelessly distorted. The firm was caught, and penalized heavily because the rate of churning had gone up after the warning, not down.

Perhaps the most familiar scripts to denigrate legal requirements display a different kind of cynicism. One of the most common forms of excuse-making is that "everybody does it," which is all at once a perception that comparable behavior is a competitive necessity and in fact socially tolerable, no matter what the law says. Psychologists point out that, often enough, that this rationalization is imagined—"naïve cynicism"—rather than based in thorough observation.[123] If so, its main function is to enable aggression (which can, in turn, become a self-fulfilling prophecy as others react to the evidence of more such behavior). The same can be said for other ways of justifying the rejection of normative commands: that the victim would have acted the same way toward us if given the chance, or that it's all just part of "the game." Researchers have long pointed to the common invocation of sports and military imagery and use of euphemisms in business settings, which provide cover for the kind of competitive arousal that tests legal and ethical boundaries.

C. Celebratory Scripts

Scripts that effectively denigrate legal compliance make it easier for other corporate values to ascend. From the Ashley Madison example, recall that behavioral ethics research has identified creativity as a precursor to ethical line-crossing, presumably because creative people are more adept at excuse-making, to themselves and others. Yet creativity is a highly-valued everywhere in

[123] See Tyler, supra, at 278, citing Dale Miller & Rebecca Ratner, *The Disparity Between Actual and Assumed Power of Self-Interest*, 74 J. Pers. & Soc. Psych. 53 (1998).

business—imagine telling Disney that they should put a lid on creativity in the name of a better culture of compliance. One can easily name other traits that are seen in the business world as exemplars—passion, focus, intensity, drive, the desire to think outside the box—that are also quite capable of inducing moral blind spots. On a more mundane level, denigration of law strengthens in comparison simple values like loyalty and community—employees of the firm and their families have a better shot at surviving and thriving in the face of intense competition. To those who feel strongly part of the corporate group (the pull of "groupishness"[124]), that is a particularly powerful motivator. The possibilities here are endless; the point is simply how easily law's normative force can be diluted by the self-serving myths conjured up by motivated reasoning.

The Enron scandal of the early 2000s, for example, was abetted by these kinds of perceptions: that the firm was "inventing" a new form of energy management for the world, requiring that it unshackle itself from old style of energy regulation and the kind of financial accounting characteristic of an earlier industrial era.[125] By reframing the legitimacy of the rules, Enron executives made themselves into the innovators, while rule abiders and enforcers were holding the world back from a better future. Elsewhere, I have described how the market worship culture in investment banking set the stage for the financial crisis.[126]

To many sociologists and some legal academics we should add to the top of this list of possibilities (with Enron as the poster child) the norm of shareholder value-maximization.[127] Indeed, there is a long-standing debate in corporate law about whether officers and directors have a fiduciary *duty* to embrace B and nothing more. While the legal answer is almost certainly no, the idea that executives have a high calling to generate shareholder wealth surely serves as a convenient rationalization for profit-making behavior absent a compelling legal instruction to the contrary. There is a growing body of evidence that publicly-owned firms face greater compliance challenges than private ones, including maintaining healthy cultures.[128] Given law's ambiguity, under-enforcement and (often enough) denigration, shareholder value maximization—myth or otherwise—presents a particularly noble-sounding script for the pursuit of

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[124] Kluver et al., supra.
[125] See generally MALCOLM S. SALTER, INNOVATION CORRUPTED: THE ORIGINS AND LEGACIES OF ENRON'S COLLAPSE (2008); LANGEVOORT, SELLING HOPE, supra, at 37-42.
[126] Id., ch. 6; see also Andrew Lo, *The Gordon Gekko Effect: The Role of Culture in the Financial Industry*, 22 Econ. Pol'y Rev. 17 (2016); HILL & PAINTER, supra; Morrison & Shapiro, supra.
[127] See SALTER, supra..
[128] See Guiso et al., supra.

whatever interests are served by the autonomous exercise of business judgment.[129]

D. The (Il)legitimacy of Compliance

In an important and instructive recent survey of corporate compliance officers, Linda Treviño and colleagues found that compliance programs face their own problems of legitimacy in business organizations.[130] They note the perception of resistance, and the reluctance of managers outside of compliance to cede to the specialists expertise in the kinds of ethical values presumably instilled long ago in church and school. Their findings are consistent with the point we have been stressing: the myriad of ways in both cognition and culture that competitive values crowd out compliance values.

This work poses the question of how others in the organization "see" (and interpret) the growth of compliance demands. Presumably, the answer again varies from firm to firm, and context to context. But I suspect that the forms of denigration described above are at work, and can become corrosive. For example, the style of internal compliance can mimic the behaviors of prosecutors, triggering impressions of overreach and excess.[131] As the technology of surveillance improves (not doubt fostered by public sector innovations in the name of national security and anti-terrorism[132]), big brother images easily come to mind.[133] There are also concerns about who is promoting compliance and why. This takes us back to our points A and B. A is socially optimal, but not achieved via law enforcement alone. B is economically optimal, at least in a short-term sense. But as we have stressed, A is also unknown—there is no consensus about

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[129] My own sense is that shareholder value is symbolically useful to senior corporate executives, but not necessarily viewed as strongly legitimate, as illustrated by how much managers denigrate the pressures of short-termism generated by investors and the marketplace. See LANGEVOORT, SELLING HOPE, supra, at 105-07.

[130] Linda Klebe Treviño et al., *Legitimating the Legitimate: A Grounded Theory Study of Legitimacy Work among Ethics and Compliance Officers,* 123 Org. Behav. & Hum. Dec. Processes 186 (2014).

[131] See Haugh, supra.

[132] See LANGEVOORT, SELLING HOPE, supra, at 97-98.

[133] See Patricia Sanchez Abril et al., *Blurred Boundaries: Social Media Privacy and the Twenty-First Century Employee*, 40 Am. Bus. L. Rev. 63 (2012). For an excellent exploration of the tension in financial services (including cultural ones) resulting from the rapid deployment of surveillance technology, see Oonig Dombalagian, *Preserving Human Agency in Automated Compliance*, 11 Brook. J. Corp. Fin. & Comm. L. --- (forthcoming, 2016).

the measure of harms corporations cause beyond that for which they are actually held responsible.

The desire to make corporations more socially responsible is long-standing, especially on matters relating to labor rights, consumer protection and environmental responsibility. It has always been a left-leaning political and intellectual project, subject to frustration as the political power of corporations increased over the last century. (To proponents, the distance between A and B or C visibly reflects the raw exercise of that power.) While that project persists in the U.S., and even more so in Europe,[134] contemporary moves in that direction have focused especially on three goals associated with the desire for greater "publicness" in powerful institutions (corporate and otherwise):[135] more transparency via disclosure; increased accountability in decision-making processes; and greater voice in those processes for affected persons. These usually take the form of governance reform, rather than substantive requirements.

The compliance movement fits neatly into the publicness story.[136] It is meant to empower a set of persons within the organization (compliance officials) whose roles are to lean against the profit-seeking pressures emanating from senior managers, shareholders and the capital markets. The turn to culture in compliance is a demand for respect for the effort, to make the journey to point A one for the entire firm. And many of the key components of modern compliance theory echo the social responsibility and publicness campaigns. We've already noticed the stress on the fair treatment of employees in the academic work on behavioral ethics; more broadly, there is the unmistakable inference that a company that becomes more socially responsible will be more compliant, as well. The goals merge.

This is not the place to debate whether governmentally induced workplace equity, social responsibility and publicness are good ideas or not.[137] My far more limited point is that to the extent those inside the corporation who are motivated to see things in the adaptive, self-serving way we've described, they are also inclined to doubt the legitimacy of this movement. The scripts here are predictable, and not entirely wrong. Compliance standards are the product of

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[134] E.g., Cynthia Williams & John Conley, *An Emerging Third Way?: The Erosion of the Anglo-American Shareholder Value Construct*, 38 Cornell Int'l L.J.. 493 (2005).

[135] See LANGEVOORT, SELLING HOPE, supra, at 27-29; Sale, supra.

[136] See William Bratton & Michael Wachter, *Tracking Berle's Footsteps: The Trail of The Modern Corporation's Last Chapter*, 33 Seattle U. L. Rev. 849, 872 (2011)("a compliance officer is a cop, a private sector cop pursuing a public goal"); on publicness, see pp --- supra.

[137] There is a body of research tying social responsibility to positive firm outcomes, including in compliance. See Harrison Hong & Inessa Liscovich, *Crime, Punishment and the Halo Effect of Corporate Social Responsibility*, May 2015, available at http://www.nber.org/papers/w21215.

informal government action as much or more than disciplined legislation or rule-making. Authority is in the hands of regulators and enforcement lawyers whose incentives (and whose own scripts) are decidedly in the direction of legal risk-aversion and control. Companies that have to bear the costs without visible benefits will suspect that the demands are an excessive burden, and to the extent they represent an incursion on efficiency and innovation, an illegitimate burden. Even when senior managers espouse strong compliance, those below may sense that they're being forced to do so by the government, against their better judgment (recall the life insurance sales story). In sum, the legitimacy challenges Treviño and her colleagues found are quite deeply rooted.

V. Useable Lessons About Compliance

The last two parts were about cultural norms that distort or deflect strong compliance messages, especially aspirational ones. The point is not that such resistance always dominates inside a firm. Firms are presumably scattered along a bell-curve continuum running from admirably high compliers to woefully low ones. But resistance is always a worry, and has to be understood and countered best as possible by those carrying out compliance responsibilities. Such is the on-going struggle of compliance.

Merely to identify the struggle, however, is a typical academic move: interesting, perhaps, but not terribly useful. So what is there more constructive to say or do? Most importantly, what best produces the conditions for a culture of compliance to succeed, as it sometimes surely does? Answers to these questions are the payoffs to our journey through the social science research, important both to those who work at preventive compliance and to law-makers who enforce compliance.

To begin, three points of general applicability. First, compliance is dynamic, not static. Personalities and cultures interact with situational pressures in ways that are ever changing. It becomes easy to assume that because all is well all will continue to be well, but that is a familiar psychological trap. One of the big challenges in all aspects of compliance is to develop mental and technological models where problems can appear suddenly and grow out of what seems to be nothing.[138]

[138] On computer based dynamic predictions of compliance and risk-taking, see Lo, supra, at 36-37. Largely outside the scope of this article are the technological changes in the workplace itself

Second, as we saw early on, the impetus for making compliance a responsibility is because the law does not effectively force corporations to bear the full social cost of the unlawful behavior. A bona fide culture of compliance seeks to minimize those costs anyway, even though it might be wealth maximizing to do less (A instead of B). This is significant, because compliance is frequently portrayed by compliance people as an effort to serve the best interests of the company and its shareholders. To an extent, it is. This compliance as "good for business" message becomes tempting, if for no reason other than to gain legitimacy in the eyes of others inside the company. But as nearly everyone who has ever thought hard about that message in the context of compliance, ethics, diversity or other public values has concluded, that is a dangerous portrayal because it implicitly makes corporate self-interest paramount.[139] Styling messages in those terms invites self-serving inference to fester, because often enough illegality *is* worth the risk from a purely calculative perspective. One clear consequence of this is that compliance and ethics must coalesce—pure legalism never gets past B.[140] Similarly, it is dangerous to paint compliance as an agency cost remedy. To be sure, where agency costs are high and managers think mainly of themselves, compliance weaknesses can become toxic and threaten the firm. It is crucial to good compliance to get from C to B. But the effort is not meant to stop there: the goal of the compliance mandate from the regulatory perspective is always A.

The third lesson is that most companies won't ever get all the way to A. Compliance norms threaten the beliefs, behaviors and cultural tropes that are instinctively success-producing. These instincts may be myths: naively cynical managers may well underestimate the benefits to the firm that come from heightened compliance and social responsibility. But they are common myths, and sticky ones. A well-intentioned CECO sensing resistance may well choose firm best interest as the prime directive in search of that elusive legitimacy,

(e.g., personal devices and networks) that can frustrate structural compliance initiatives by diverting behavior into less observable spaces and speeding up the retransmission of beliefs and attitudes. See John H. Walsh, *Compliance in the Age of Connectivity,* Rutgers L.J. (forthcoming 2017). These changes affect culture, too.

[139] See Paine, supra. This conundrum affects not only compliance but other forms of social responsibility, diversity, etc.—to see them as "good for business" cheapens their intrinsic moral content.

[140] That much seems increasingly accepted in the business community, at least structurally. Separation of the ethics and compliance function (the role of the CECO) from the legal function is now fairly commonplace, at least partly because the act of representing the corporation calls for an aggressive attitude that may not best foster ethical aspirations. See Treviño et al., supra, at 146; Tanina Rostain, *The Emergence of "Law Consultants*," 75 Fordham L. Rev. 1397 (2006); Langevoort, *Getting (Too) Comfortable*, supra, at 500-02. Not everyone agrees. See DeStefano, supra. One negative consequence of separation is that the internal legal function is coded as outside of ethics and social responsibility.

fearing that a strong embrace of point A will simply fail and hoping that the structural tools put to work in the name of protecting the corporation will catch or deter a broader range of wrongdoing. It may well be that firms whose cultures fall even half-way between A and B grade high on the effort scale, at least when the grading is on a curve.

A. Lessons for Firms

1. Editing the Scripts

Merely communicating the desired goal of strict law-abidingness is never enough. Good communication is essential, and has to be persistent, unambiguously tied to the real choices managers make on a day-to-day basis.[141] One of behavioral ethics key insights is that ethical prompts that occur too early before a choice have little impact—most people intend to do the right thing, until immediately faced with a dilemma.[142] The messages have to be values-based, not strategic, and not undermined by inconsistent behaviors and directives from the senior management team. This much seems to be a given in the sophisticated contemporary compliance manual, if not always followed faithfully in practice.[143]

More specifically, the resistance to a culture of compliance is often via scripts, and so much of the compliance effort must be to rewrite them. To use our example from earlier, if people in sales have come to place great faith in written disclosures to customers—so that aggressive sales tactics are fair after disclosure—then someone has to expose the illusion: disclosure does not dependably put customers on guard, and can often *enable* opportunism.[144] One of the key jobs for compliance is to uncover the cultural language and impressions that facilitate risky thinking and behavior.

As noted, denigration of law and law-makers (or enforcers) is another enabling script. While there may be considerable realism in the perception that law-making is a flawed enterprise, it may still help to bring to managers' attention on an on-going basis the genuine challenges of regulation—the why behind rule-

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[141] See Killingsworth, supra; Regan, supra.
[142] E.g., Ann E. Tenbrunsel et al., *The ethical mirage: A temporal explanation as to why we aren't as ethical as we think we are*, 30 Res. Org. Behav. 151 (2010).
[143] See sources cited in notes --- supra.
[144] See sources in note – supra.

making and enforcement, and the histories of abuses, in the hope that perceptions inside the company can become a little less jaundiced. Compliance should be a voice for why regulation is needed, even helpful, for honest firms in a world filled with too many lemons.

Self-protective scripts allow managers in the firm think of themselves and their groups as highly ethical and creatively reinterpret behaviors to the contrary in order to maintain consistency with that view. There is among most all of us, sadly, some level of moral hypocrisy, but especially among the most powerful.[145] That is hard to dislodge, but perhaps made a bit easier by getting managers to acknowledge first the dangerous power of rationalization in others. Case studies of conflicts of interest and other compliance failures—inside the firm and elsewhere—can be portrayed in behavioral terms, with the hope that dwelling on this long enough will cause the audience to see that they could hardly be immune to those same self-blinding heuristics and biases. The message is that smart people with the best of intentions threaten some of the biggest harms to both their own moral identity and the corporate community. The single most powerful compliance message—the best way to knit genuine moral habit-formation with sustainable corporate interest—is to get managers and employees to accept their own fallibility when taking legal and other risks. A message of humility, in other words.

These are constructive lessons to convey to others, but there are also cautionary ones for compliance people themselves to learn. It becomes very easy for compliance officials to react to resistance and doubts about their legitimacy by upping the power of the powerful tools they have at their disposal: surveillance and monitoring. They start behaving more like cops on the beat. Although there surely is a place for such intrusion, one of the key insights of research in both behavioral economics and behavioral ethics is that monitoring intensity can backfire.[146] Heavy monitoring can be a threatening sign of distrust, crowding out any residual internal motivation on the part of the monitored to do the right thing because it is right. Under certain circumstances, then, an increase in monitoring can actually increase misbehavior, not decrease it. One of the culture-oriented tasks for constructive compliance is explaining the presence of necessary tools in a way that is less likely to provoke dangerous reactance or demoralization, and avoiding excess.

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[145] Joris Lammers et al., *Power increases hypocrisy: moralizing in reasoning, immorality in behavior*, 12 Psych. Sci. 737 (2010).
[146] See Tyler, supra; Langevoort, *Monitoring*, supra, at 94-100.

2. Hiring and Promotion

One of the intractable problems in building a culture of compliance is that certain traits that are, on average, negatively correlated with ethical responsibility are positively correlated with competitive success. Competitiveness itself, plus creativity, confidence, optimism, intensity, focus and dogged persistence all have evil twins in terms of mental capacity and internal motivation to bend rules.

It is probably a losing proposition to suggest that corporations shy away from people with those traits in favor of strict moral rectitude—competitive firms tend not to recruit heavily from seminaries and schools of social work. Most human resources experts put power and leadership traits on the top of the corporate wish list. But the message to compliance is clear: to the extent that those traits are especially prized and celebrated in the corporate culture, they can become dangerous. Some script editing is due here, too.

Another given in values-based best practices is to assure that incentives inside firms—especially those related to promotion and compensation—are consistent with expressed ethical values.[147] That is to say, if people are expected to reach and surpass unreasonable goals, many will take it as license to cheat. If those with stricter ethical values are passed over in promotion in favor of the more ethically plastic, the cultural message will again be clear. What we've seen simply adds to the importance of this. All it takes is a tendency (perhaps subconscious) to take greater ethical or legal risks to become favored in a corporate promotion tournament supposedly based on merit.[148] Even if the law is optimally enforced, in large numbers of iterations there will be some lucky risk-takers who do not get caught, and who will thus appear to be especially skilled and productive. If they are the ones promoted, they become cultural exemplars and evangelists for their style of flexibility (or competitive intensity, focus, etc.).[149] But the law is rarely optimally enforced, as we've seen—and sometimes horribly under-enforced[150]—so that the odds then become even more stacked in their favor. The pathways to power have to be another compliance watch-list item. (Though outside the scope of this article, the connections among hiring and

[147] E.g, Weaver, supra, at 310. On how this plays out in financial services, see Laby, supra, at 1192-98.
[148] See Langevoort, *Getting (Too) Comfortable*, supra, at 503-05.
[149] See Killingsworth, *C-Suite*.
[150] See p. --- supra.

promotion patterns, diversity—especially gender diversity—and compliance deserve more attention than they get.[151])

3. Fairness

One dominating message from the behavioral ethics literature is that perceived fair treatment of managers and other employees is important to good behavior.[152] Those who feel mistreated are more likely to cheat vis-à-vis the firm, whether in retaliation or simply because of a sense of moral license. Presumably the latter can produce behaviors that harm third-parties (stakeholders) as well, as a way of evening the score.[153]

Building a fair internal governance system seems self-evidently a good idea, but equally self-evidently hard to pull off. Research indicates that those who exercise power aggressively are persistently seen as stronger leaders than those who seek reputations for being fair.[154] Perceptions of fairness, moreover, are notoriously subject to motivated reasoning—there are strong egocentric biases to the construal of what is fair.[155] Assignments of fault and blame often generate intense denial and defensive bolstering,[156] making them seem unfair whether or not they would be so to an unbiased observer. And often enough, the perception of unfairness is justified. Pressures from above can often become unreasonable, prompting frustration, loss of control and an increased ability to justify cheating. Imagine a setting where the CEO has put off a hard choice until it becomes intractable, and then demands that a vice president solve it anyway. That's not fair, which can easily prompt irresponsible action in return with little or no guilt. Whether the CEO had any appreciation that he or she set all this in motion by lack of leadership (probably not) is unimportant.

[151] See Donald C. Langevoort, *Overcoming Resistance to Diversity in the Executive Suite: Grease, Grit, and the Corporate Tournament*, 61 Wash. & Lee L. Rev. 1615 (2004). There is substantial evidence that, on average, women are more ethically responsible (and less prone to self-serving inference) than men. While the organizational dynamics here shouldn't be oversimplified, there is probably a good case that greater gender diversity in leadership positions will lead to better ethics and compliance. See LANGEVOORT, SELLING HOPE, supra, at 157-59.

[152] See TREVINO & WEAVER, supra, at 267-92; Tom Tyler et al., *The Ethical Commitment to Compliance: Building a Values-based Culture*, 50 Cal. Mgt. Rev. 31, 36-40 (2008)..

[153] See Daniel Houser et al., *Fairness and Cheating*, 56 Eur. Econ. Rev. 1645 (2012).

[154] Batia M. Wiesenfeld et al., *Why Fair Bosses Fall Behind*, 89 Harv. Bus. Rev. 26 (No. 7-8, 2011).

[155] See Leigh Thompson & George Loewenstein, *Egocentric Interpretation of Fairness and Interpersonal Conflict*, 51 Org. Behav. & Human Dec. Processes 176 (1992).

[156] See Jennifer Lerner & Philip Tetlock, *Accounting for the Effects of Accountability*, 125 Psych. Bull. 255, 257-58 (1999).

These are daunting challenges, probably dooming any effort to establish intrinsic fairness as the single most celebrated norm in the corporate culture. But this is a place where the perfect may be the enemy of the good. Research shows that "the most effective leaders are generally those who give employees a voice, treat them with dignity and consistency, and base decisions on accurate and complete information."[157] Notwithstanding how much behavioral researchers stress them, fairness and its correlates remain under-appreciated, in its connection both to a healthy culture of compliance and to positive organizational change.

4. Metrics

Perhaps the "holy grail" question in culture of compliance studies is whether there is a reliable mechanism for measuring the organizational climate with respect to ethics and compliance. Compliance consultants and organizational researchers have given much thought to the design of confidential survey tools that ask a broad sample of managers or employees to answer a set of questions about how ethical the organization is perceived to be, how often they feel pressure to cheat, and how often they have observed misbehavior by others.[158]

It is not hard to critique these tools. Our story gives ample reason to believe that individual employees develop the ability to deflect perceptions that threaten their self-image, which likely operates on a group level as well. Survey answers, then, may come mindlessly from available scripts, burying evidence of guilt for self and others.[159] Even more obviously, when the surveys are administered under the authority of higher-ups, some managers and employees will give the answers they think their superiors want to hear, not necessarily the truth. These critiques are hardly damning, however. Even if there is some inflation bias built in, compliance personnel might get useful comparative information. That is, discovering settings where the responses are relatively more disturbing—or trend in a particular direction—may be helpful compliance intelligence as to where the sharper tools of compliance (audit, surveillance, etc.) are especially needed.

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[157] Wiesenfeld, supra.

[158] See John Cullen & Bart Victor, *The Ethical Climate Questionnaire: An Assessment of its Development and Validity*, 73 Psych. Rept's (2008).

[159] Francesca Gino et al., *See No Evil: When We Overlook Other Peoples' Unethical Behavior*, in R. M. KRAMER ET AL., EDS., SOCIAL DECISION MAKING: SOCIAL DILEMMAS, SOCIAL VALUES, AND ETHICAL JUDGMENTS 241 (2009).

Whether compliance officials are motivated to conduct honest surveys is another matter (and a good time to note that motivated biases and cultures affect compliance personnel, too). Bad news in the field in terms of perceived ethicality and law-abidingness casts a bad light on the compliance team's own performance, and is hardly the kind of news the upper echelon wants to hear, material though it might be. And as others have pointed out, the possibility that bad findings might find their way to regulators, plaintiffs' lawyers, competitors or the media has to be especially scary. That has long led some to call for a self-evaluation privilege for compliance monitoring.[160] But with such materiality to troubling findings, courts and regulators are naturally reluctant to make such assurances. The bottom line in all this is that some external pressure would probably be needed to prompt more survey-taking, and that such pressure will at the same time decrease the incentive for loyal employees to give candid answers. Indeed, the reasonable fear may be just the opposite: that profit-oriented compliance consultants become adept at generating impressive-looking surveys that are biased to give the rosy results that the upper echelon would much rather have in its possession.

B. Lessons for Policymakers and Enforcers

1. *Ex Post:* Prosecution and Enforcement

As noted, there is now a sizable literature on the role of government enforcers—mainly DOJ—in establishing compliance obligations and compliance monitoring via deferred and non-prosecution agreements. Most all of it is critical. The criticism is that prosecutors lack the expertise and incentives to create meaningful reforms that reduce the risk of recidivism, thereby imposing unnecessary costs or—if these terms are in lieu of some stronger sanction—diminishing deterrence. After reforms are imposed, prosecutors lack the time, resources or desire to revisit the firm to see whether the reforms made any difference. They have too much else to do, and have moved on. The strong suggestion is that enforcers back away from imposing compliance-related reforms.

The concerns about expertise and incentives cut in different ways. One, simply, is that the reforms do more harm than good. Another is that enforcers

[160] See Joseph E. Murphy, *The Self-evaluative Privilege*, 7 J. Corp. L. 489 (1982).

naively believe they are efficacious and demand less in more conventional kinds of sanctions than they otherwise would, thereby achieving less in deterrence and anti-recidivism.[161]

Those are all serious concerns, but can easily be overstated. For example, a mandated reform that increases the corporation's compliance budget for a multi-year period, rearranges reporting lines and internal oversight, and/or causes new officers or directors to replace irresponsible incumbents are not so obviously outside the competence of enforcers, especially when we take into account that the biggest compliance problems usually reflect agency cost infections and corporate governance has already failed.[162] Though some of these targeted reforms might turn out to be wasteful, sticking to the compliance status quo could just as easily perpetuate inadequacy. So, too, with forced personnel changes at the officer-director level. For corporate shareholders, such are the consequences of corporate wrongdoing.

A thorough discussion of these structural reform issues is beyond the scope of this article, however. The question for our purposes is what, if anything, culture adds to this debate. As to whether prosecutors are particularly adept a deep anthropological understanding any given firm's culture, the answer is surely not. Enforcers usually think about compliance only after finding evidence of wrongdoing, and bring their own set of cognitive and cultural biases, some perceptual,[163] others motivated.[164] Public enforcers are overly likely to see and

[161] A third possibility is that these reforms are intentionally cosmetic, meant only for public consumption and used as a bargaining chip in settling cases. See Krawiec, supra.

[162] See Arlen & Kahan, supra. An important open question is whether the trauma of government prosecution itself will invigorate governance reforms to regain shareholder or stakeholder trust, so that the mandated reforms aren't necessary even if there previously was a governance failure. Cf. Francois Brochet et al., *Accountability of Independent Directors: Evidence from Firms Subject to Securities Litigation*, 111 J. Fin. Econ. 430 (2014)(directors face greater discipline in the aftermath of fraud claims).

[163] There is a large and long-standing literature on behavioral biases and agency costs in government agencies, from which legal scholars have drawn. E.g., Donald C. Langevoort, *The SEC as a Bureaucracy: Public Choice, Institutional Rhetoric and the Process of Policy Formulation,* 47 Wash. & Lee L. Rev. 527 (1990); Stephen Choi & Adam Pritchard, *Behavioral Economics and the SEC*, 56 Stan. L. Rev. 1 (2003). These include hindsight biases and attribution biases, which together make bad events more predictable and more the product of a bad disposition than the facts would otherwise indicate. See Neal Roese & Kathleen Vohs, *Hindsight Bias*, 7 Persp. on Psych. Sci. 411 (2012); in law, see G. Mitu Gulati et al., *Fraud by Hindsight*, 98 Nw. U. L. Rev. 773 (2004); Langevoort, *Monitoring*, supra, at 84, 89.

[164] While there is empirical evidence to support the prediction that white collar crime prosecutors have career-based incentives to be aggressive, reality is much more complex. A large literature on "cultural capture" explores ways regulators become too accepting of existing power structures. See James Kwak, *Cultural Capital and the Financial Crisis*, in DANIEL CARPENTER & DAVID MOSS, EDS., PREVENTING REGULATORY CAPTURE: SPECIAL INTEREST INFLUENCE AND HOW TO LIMIT IT 73 (2014). To the extent that reform settlements are more symbolic than real—and don't really threaten the autonomy of managerial incumbents—such settlements may, as critics suggest,

attribute a bad outcome to a bad culture, just as those inside firms are blinded to the same possibility. Once a particular corporation is perceived as a wrongdoer, moreover, there is little sympathy for complaints about future compliance costs. This harms the subject of the prosecution, but also has spillover effects. These agreed-to non-prosecution and deferred prosecution agreements[165] may become models of the normal for other firms when interpreted and retransmitted by lawyers and compliance consultants. If costs are ignored or misunderstood, or benefits turn out to be illusory, these problems are magnified.

A second useful lesson is much the same as what compliance offers have to learn, but applies even more starkly. Compliance interventions have to be crafted with a light touch or they will backfire. Perception matters. When prosecutions are heavy-handed, or appear so to the business community, we've seen the reactance that can occur. A reform that may be well-intentioned as a way of shedding the bad organizational routines and habits that led to the alleged crime at a particular firm can be interpreted as intrusive signs of mistrust to those who had nothing to do with the misbehavior. As we've just seen, according to the behavioral literature, cultures cannot become truly values-based if adopted under external pressure. The harder enforcers push, the more the business goal simply becomes not getting caught, or treating the penalties as a cost of doing business. The fine becomes a price,[166] and point B, or worse, is reinforced as compliance's center of gravity.

Indeed, if culture is as important as theory and evidence suggest, the government-backed arms race of expenditures on structural compliance monitoring and surveillance, both human and cyber-based, could probably slow down. Monitoring has its place, to be sure—nothing in our discussion of the crowding-out phenomenon suggests that oversight and discipline carefully aligned with the firm's values is either unnecessary or inappropriate. It's just that absent Orwellian kinds of surveillance,[167] these tools have diminishing marginal returns when up against an entrenched culture, and may inadvertently stoke resistance. Pro-sociality is more likely to flourish in corporate cultures when the compliance

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detract from doing justice. See GARRETT, supra. Corporations might welcome that to the extent that culture shifts attention away from the more costly and intrusive structural changes to compliance and governance that regulators might demand. See Griffith, supra, at 2127-28.

[165] Which are increasingly used by regulatory agencies like the SEC, not just DOJ. See Barnard, supra; Gibson Dunn, Client Alert: *2015 Year End Update on Corporate Non-Prosecution Agreements and Deferred Prosecution Agreements*, available at http://www.gibsondunn.com/publications/Pages/2015-Year-End-Update-Corporate-Non-Prosecution-Agreements-and-Deferred-Prosecution-Agreements.aspx.

[166] On the experimental evidence, see Uri Gneezy & Aldo Rustichini, *A Fine is a Price*, 29 J. Legal Stud. 1 (2000).

[167] See Fanto, supra.

environment is cleansed of external pressure and threats. The same can be said about enforcer-imposed compliance monitors.[168] If cultural values come from within, it is unlikely that a temporary compliance "czar" will contribute much and will face much motivated resistance—masked by polite smiles and fawning acquiescence in paper reforms—during his or her reign.[169]

All of these points underscore that enforcers have to be cautious and modest in negotiating reform settlements. At the same time, they simply cannot leave compliance—especially cultures of compliance—to firms to figure out for themselves. The main message of this article is how easily cultures under stress turn self-serving. If the government takes no vocal role in articulating public norms of corporate legal responsibility, it is not clear who will. The dark side wins the internal debate a little too easily and often. Point A gets lost, in other words. Corporations that celebrate the crucible of competition assume many risks, the costs of which are felt widely in society and not fully internalized. In the end, a culture of compliance is one where people really have come to believe in more than internal rate of return in how those risks are managed. Pro-sociality needs a boost that will often not come spontaneously from inside the firm.[170]

Thus, there is much to be said for a prosecutorial policy that takes into account the cultures it finds in the course of prosecuting corporate misbehavior and judges it against the socially expected ideal (point A). Charging and sanction decisions should be affected, though by how much has to be highly fact-dependent.[171] In other words, enforcers should look and listen in the course of their investigations for evidence of something more than compliance-speak in how the firm's values are articulated and promoted, giving salient credit when due for both effort and achievement, and equally visible refusal when there appears to be neither. The key function of this judgment is to give legitimacy and voice to the publicness of corporate compliance, an expressive function. Beyond that, prosecutorial settlement terms should exhibit restraint suitable to how much we still don't know about compliance, cultural and otherwise.

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[168] See O'Sullivan, supra, at 67-70.

[169] I leave to others the assessment of current policy about compliance monitors and how it might be improved. See David Hess & Cristie L. Ford, *Corporate Corruption and Reform Undertakings: A New Approach to an Old Problem*, 41 Cornell Int'l L.J. 307 (2008). Hess and Ford are probably right to see the compliance monitor more in the role of mediator, not an enforcer left behind to impose a new compliance order on the vanquished.

[170] To this end, Hess, supra, calls for a revision to the OSG to insist on attention to values-based compliance.

[171] As Geoff Miller indicates, the amount of the credit or debit for compliance as a whole (culture included) should be fairly moderate in light of the difficulties of judging accurately. See Miller, supra. Realistically, since most investigations are settled, corporations and their counsel will probably work hard to persuade the government not to comment adversely on the culture.

2. *Ex Ante:* Regulatory Monitoring

More and more, regulatory agencies are getting into the business of assessing compliance without waiting for the kind of failure that makes the matter one for enforcement in the first instance. This is often because the governing statute insists on reasonable or adequate in-house risk controls, which encompass compliance risks, or has an explicit standard of adequate supervision inside the firm. As noted, this is particularly the case in securities and financial services regulation,[172] especially after the financial crisis and its wide-ranging legislative response, the Dodd-Frank Act. As technology evolves, the capacity to surveil and interdict on a real-time basis is growing rapidly.[173] Here, too, culture gets its due.

This subject is interesting not only as a legal matter but because assessing compliance takes on a purer form when there is no salient wrongdoing to potentially bias the assessment. Inspections and examinations of the structural aspects of compliance can be a mind-numbing review of written supervisory procedures and their implementation, rarely yielding much except for gaps. No doubt part of the new cultural emphasis is to redirect the dialog from details to principles and push the widely-shared intuition that supervisory procedures are more a matter of attitude and motivation than who does what, and when. Because supervisory regulators see all firms, not just noncompliant ones, they are in a better position than enforcers to identify the good, not just the bad, and spread the message.

There is an important middle-ground legal issue here. Sometimes an agency like the SEC discovers a compliance failure and a substantive violation. It will punish the individual violator, and often the firm as well. It also has the authority to punish supervisors, so does that mean it can or should go after compliance personnel who may have missed the infraction?[174] This is a sensitive issue because the penalties (usually a temporary bar from work and a fine) are amplified by collateral consequences: the penalty becomes a matter of searchable public record, and most securities firms are naturally uneasy about hiring or retaining compliance personnel with a blot on their compliance record. Career consequences may be drastic.

[172] See Walsh, supra, and Fanto, supra, for descriptions of the SEC's oversight of broker-dealer and investment advisor supervisory procedures.
[173] See Lo, supra.
[174] See Ted Urban, *Avoiding Supervisory Liability*, in HUI & WALSH, supra, at 703.

The policy issues here are confounding. As we've seen, compliance is a struggle as it is, encountering resistance both conscious and unconscious. Failures will often not be compliance's fault, especially when (as is usual) they have no authority to fire. And we certainly don't want to discourage compliance interventions by imposing supervisory liability when the compliance official tries but fails. Jim Fanto has drawn from the behavioral ethics literature noted earlier to argue that, beyond all this, compliance needs to take on the role of internal firm conscience, which will be undermined if the compliance role itself is subject to overbearing external threats.[175]

All that is quite right, but produces a dilemma. Compliance personnel may take responsibility for approving a particular decision or practice. Absolving them from liability may lead to the situation where line personnel offer the excuse that they got approval from compliance; compliance says they didn't have direct supervisory authority, so can't be penalized. A fair concern from our study of compliance cultures is that some in compliance can and do succumb to both cultural and economic pressures, and when they have essentially "thrown in their lot" with the questionable behavior, deserve a penalty. That is the essentially the SEC's position, and presumably of other regulators with similar statutory authority, but heavily criticized. The fear once again is that thoroughly deregulating the compliance space in order to let conscience flourish will instead leave the field open to the self-serving biases to which business cultures are so subject. Regulators need to be very cautious about compliance official liability, to be sure, but via moderation, not abandonment. As noted there are doubts about regulators' judgment in assigning blame after salient misconduct within a firm, but not enough to advocate a liability-free zone.

That said, the examination and inspection process should be a threat-free as possible when it comes to culture, for all the reasons Fanto gives. To borrow from new governance scholarship, this should be the setting for the kind of dialog that facilitates learning and responsiveness.[176] Compliance is naturally fixated on point B; regulators have to advocate for A, perhaps against heavy odds. The lessons for regulators are in many respects the same as the message for well-meaning compliance officials inside the firm: helping to rewrite scripts to wean

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[175] Fanto, supra, at 1163-65.

[176] See Baer, supra, at 956; see also Hess & Ford, supra; Cristie L. Ford, *New Governance in the Teeth of Human Frailty: Lessons from Financial Regulation*, 2010 Wisc. L. Rev. 101 (2010); Conley & Williams, supra, at 116-20; Bird & Park, supra.

people, practices and cultures away from self-serving inference and motivated biases.[177]

Some questions and topics of conversation seem natural. Hiring, promotion and compensation are obvious subjects,[178] but we have seen more subtle aspects of common practices of aggressive goal-setting and the celebration of personalities who exhibit an abundance of competitive arousal, creativity, or self-confidence. The role of fairness in how people are (and feel) treated inside the firm is another subject that deserves clear discussion. More broadly, it is worth raising questions about how free—indeed, responsible[179]—do people feel to speak up and question, not only about legal wrongdoing (whistle-blowing) but on any matter relating to firm culture and firm performance. Whistle-blowing, which is important to compliance, is more likely when not viewed as a stand-alone practice but part of a larger culture of candor.[180]

It is naïve to assume that the dialog between regulators and the regulated will be particularly honest and soul-searching, given mutual suspicions. But a good faith effort is the best route to a meaningfully internalized culture of compliance. These conversations are worth having, skepticism notwithstanding.

VI. CONCLUSION

Compliance—cultural and otherwise—inhabits the uneasy borderland between the public and the private. Advocating a genuine culture of compliance takes government prosecutors and regulators to a strange place. Culture is crucial to compliance, but we are still early on the road to understanding how and why. Pressing hard may make cultures more compliance resistant, not less. There are costs to pushing a culture of compliance, some quite subtle and hidden. Compliance norms affect risk-taking and creativity. The very idea of getting from

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[177] See Lee Augsburger, *How Compliance Can Teach Ethics*, and Michelle Hawkins, *Soft Skills Presenting Compliance*, in HUI & WALSH, supra, at 179, 207.

[178] In securities, this would include the tendency of some firms to hire aggressively brokers with prior disciplinary records, presumably on the (highly rationalized) belief that special supervision will work. See note --- supra.

[179] Often forgotten is the fiduciary *duty* all agents have to the corporation to convey truthfully all material information necessary for higher ups to carry out their obligations. See Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. Cinn. L. Rev. 1187 (2002).

[180] See Yuval Feldman & Orly Lobel, *The Incentives Matrix: The Comparative Effectiveness of Rewards, Liabilities, Duties and Protections for Reporting Illegality*, 88 Tex. L. Rev. 1151, 1176 (2010).

B to A involves the abandonment of corporate wealth maximization or efficiency as primary norms, which is justifiable only if the interventions pay off in meaningful social benefit, not political spittle. So it is difficult not to share the critics' fear that DOJ prosecutors, in particular, currently have neither the incentives nor evidence to make accurate assessments or generate sensible policy for corporations to follow in order to avoid further trouble.

But compliance has become a public norm, and the necessary expectations have to be generated publicly. Corporate governance will never suffice to produce the desired attitude (an embrace of point A) even if all agency cost issues are magically resolved. This effort is not meant to sound wildly idealistic, suggesting that government policies on cultures of compliance can cultivate pro-social, law-abiding forces inside the firm simply with an abundance of sunlight and care. Once again, the crucial point is far less ambitious: how much worse things might be without any pushback to the cultural tropes and scripts that enable the internal lubricants to spread and become all the more slippery. Government enforcers may have to undergo their own culture change to understand how to do this well, but prosecutors and enforcers need to play their role, hopefully with the best knowledge and tools available, in rewarding good corporate cultures and penalizing bad ones.

I make no prediction about whether that will ever happen. But regardless of whether the regulatory turn to culture is real or feigned, justifiable or illegitimate, governmentally-induced compliance is here to stay. Those with compliance responsibilities inside firms have to confront their own cultures every day. In the end, the most important message about cultures of compliance is for corporate leaders and, especially, boards of directors.[181] It is much too easy to look around and see good people working hard at difficult jobs and assume that a good compliance culture exists simply because everyone has been warned of the damage that can come from getting caught doing wrong. Or worse, to assume that an observable abundance of intensity, loyalty and creativity are signs that all is good. Taking culture seriously—appreciating the opportunities for transmitting values as well as anticipating the many hidden pathways of resistance and denial—is a necessary step toward the sort of compliance that never attracts prosecutors' unwanted attention.

[181] See Killingsworth, *C-Suite*, supra; Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals about Self-Deception, Deceiving Others, and the Design of Internal Controls,* 93 Geo. L.J. 285-317 (2004).