Diversity, Compliance, Ethics & In-House Counsel

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INTRODUCTION

Judge Stanley Sporkin once asked "[w]here ... were [all] the ... attorneys" when considering the wrongdoing and ethically dubious misconduct underlying the savings and loan crisis of the 1980s. Variations of this question pop-up with each new financial fraud of any significant magnitude. After the Enron series of financial frauds, around the turn of this century, Congress acted aggressively to empower attorneys to blow the whistle on frauds within publicly-traded firms. Within the publicly-traded firm, policymakers assume that serious wrongdoing cannot occur without at least arousing the suspicions of some attorney that supposedly represents the corporation and is duty bound to protect shareholders from the adverse consequences of wrongful conduct, such as securities fraud. On the other hand, attorneys ultimately work under the supervision of senior management of the firm, and this fact impedes the ability of counsel for the firm to blow the whistle on any wrongdoing within the firm or outside the firm, if senior management is involved or benefits in the wrongdoing. In-house counsel, in particular, may face termination for blowing
the whistle on wrongdoing. This essay posits that cultural diversity can help in-house counsel achieve superior ethical, compliance, and reputation risk management outcomes for their firms, and therefore in-house counsel should seek to maximize cultural diversity within the corps of corporate counsel representing firms, and throughout the firm.

The most recent financial frauds—those that almost destroyed modern capitalism in 2008-2009—involved massive securities fraud, which could not possibly have occurred without the participation or knowledge of some lawyer that putatively represented the public firms at the center of that catastrophe. The Great Financial Crisis of 2008-2009 (“Great Financial Crisis”) illustrates the difficulty of creating proper incentives for attorneys to blow the whistle on fraud occurring within client firms, either to the regulatory authorities or to senior management inside the firm. Indeed, I wrote in 2010 on this very topic with a view to suggesting significant adjustments to facilitate the legal compliance role that attorneys should play to protect the shareholders of public firms. Specifically, I proposed an independent legal compliance committee that could receive anonymous reports from corporate counsel and others with evidence of


7. Orlando C. Richard et al., The Impact of Racial Diversity on Intermediate and Long-term Performance: The Moderating Role of Environmental Context, 28 STRATEGIC MGMT. J. 1213, 1229 (2007) (“Cultural diversity exists when people with distinct and different group affiliations of cultural significance are found within larger group or organization.”). This implies no compromise in terms of financial performance. “The delightful discovery is that beyond moderate levels of diversity we find a positive effect of racial diversity on both our short-term and long-term measures of performance.” Id. at 1229.

8. Steven A. Ramirez, The Virtues of Private Securities Litigation: An Historic and Macroeconomic Perspective, 45 LOY. U. CHI. L.J. 669, 700-08 (2014) (providing a detailed history of the Enron Scandal and the run-up to the 2008 Financial Crisis). Even after the financial frauds underlying the Great Financial Crisis occurred, new scandals involving the silence of in-house counsel emerged. See Sung Hui Kim, Inside Lawyers: Friends or Gatekeepers?, 84 FORDHAM L. REV. 1867, 1867-68 (2016) (“Though primary blame should perhaps rest with GM’s engineers, who apparently did not understand how their vehicles were built, GM’s inside lawyers, who handled engineering, safety, and products liability issues, must be faulted for having obscured the deadly defect.”).

9. Ramirez, supra note 8, at 707 n.251 (explaining that “the term ‘Great Financial Crisis of 2008’ [denotes] the massive global financial market disruption that commenced with the failure of Lehman Brothers on September 15, 2008 and ending in the spring of 2009 when the U.S. stock market hit a low of below 7000 in the Dow Jones Industrial Average” in accordance with the recognition of two former Federal Reserve chiefs that this crisis inflicted “unprecedented virulence” on the American financial system).

10. Under the Model Rules of Professional Conduct: “A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.” MODEL RULES OF PROF’L CONDUCT r. 1.7 (AM. BAR ASS’N 2016).

wrongdoing. In the years since the crisis, no evidence of any attorney whistleblower emerged, save one female lawyer. While Congress enacted the Dodd-Frank Act in 2010, that Act did not materially change the duties of counsel representing firms, even financial firms. Thus, no significant change regarding the duties of counsel occurred after the Great Financial Crisis, or since the subprime debacle.

This essay suggests that in-house counsel interested in protecting shareholders from the costs of misconduct within their firms, however, can take proactive steps to protect shareholders from the kind of skullduggery that drove all aspects of the subprime crisis, as well as the Enron series of frauds. Along the way, in-house counsel may help avert future macroeconomic crises like the one that followed in the aftermath of the Great Financial Crisis. Part I shows that because of fundamental differences in acculturation experiences, diverse groups hold different perspectives on ethics, compliance and risk. Part II explains the recent legal and regulatory evolution of corporate counsel's gatekeeper role in assuring that the corporation complies with law and adheres to ethical norms, and it explores why that evolution has not stopped corporate counsel from remaining silent in the face of manifest misconduct. Part III focuses on how general counsel and attorneys working in-house at public firms can overcome the well-known barriers counsel faces in achieving a superior outcome in risk management related to ethics and compliance using enhanced

12. I proposed an independent committee of the board composed entirely of lawyers that would function to receive reports of wrongdoing within the firm (including anonymous reports) and to conduct an annual legal compliance audit. Id. at 362-63.


15. Congress did act to enhance cultural diversity in the financial sector. See Kristin Johnson et al., Diversifying to Mitigate Risk: Can Dodd-Frank Section 342 Help Stabilize the Financial Sector?, 73 WASH. & LEE L. REV. 1795, 1867-68 (2016) (concluding that Congress acted appropriately in seeking to diversify the financial sector).

16. See RAMIREZ & RAMIREZ, supra note 13, at 1-27, 31-40 (providing an overview of the wrongdoing underlying the Great Financial Crisis and the Enron era criminal frauds).

17. By any reckoning, the Great Financial Crisis of 2008-2009 was a multi-trillion-dollar catastrophe. See Tyler Atkinson et al., How Bad Was It? The Costs and Consequences of the 2007-09 Financial Crisis, 20 FED. RES. BANK OF DALL.: STAFF PAPERS 1-2, 19 (2013), https://dallasfed.org/assets/documents/research/staff/staff1301.pdf (estimating total cost of crisis in United States alone at up to fourteen trillion dollars and suggesting that the trajectory of potential GDP may be permanently lower).
cultural diversity. The essay concludes that cultural diversity gives in-house counsel a key tool for guiding the corporation to superior shareholder value and sustainable financial performance.

I. THE DIVERSITY DIFFERENCE IN COMPLIANCE AND ETHICS

In the legal academy, much debate has surrounded the efficacy of cultural diversity along a number of important metrics. Nevertheless, skeptics of the value of cultural diversity only rarely focus on the best practices for empowering diverse voices that are necessary for unleashing the power of cultural diversity. In studies focusing on the best managers of diversity, including the notion that diversity management requires empowering diverse voices and achieving a critical mass of diversity, the benefits become manifest relative to studies that include those pursuing mere tokenism. This essay builds on the premise that management of cultural diversity is critical to unleashing its benefits.

18. See, e.g., Steven A. Ramirez, Diversity and the Boardroom, 6 STAN. J.L. BUS. & FIN. 85 (2000) (collecting sources regarding the advantages of a diverse workforce). More recently, scholars recognize that while well-managed diversity may lead to superior board performance, the empirical data on the mere presence of diverse board members is mixed. See Deborah L. Rhode & Amanda K. Packel, Diversity on Corporate Boards: How Much Difference Does Difference Make?, 39 DEL. J. CORP. L. 377, 393 (2014) (“Although empirical research has drawn much-needed attention to the underrepresentation of women and minorities on corporate boards, it has not convincingly established that board diversity leads to improved financial performance.”); Lissa Lamkin Broome & Kimberly D. Krawiec, Signaling Through Board Diversity: Is Anyone Listening?, 77 U. CIN. L. REV. 431, 432-33 (2008) (“Recent quantitative studies primarily test for a relationship between board diversity and various measures of corporate performance ... studies find evidence that ... board diversity positively affects firm performance. Other studies, however, find no support for this theory.”); Lisa M. Fairfax, Clogs in the Pipeline: The Mixed Data on Women Directors and Continued Barriers to Their Advancement, 65 MD. L. REV. 579, 593 (2006) (summarizing the empirical data addressing the impact of diversity contingent upon the number of women in the boardroom). Rhode and Packel acknowledge that well-managed diversity and diversity arising from a critical mass of voices may support different conclusions than that reached in their review in 2014. Rhode & Packel, supra, at 377, 408-11. See also Kristin N. Johnson, Banking on Diversity: Does Gender Diversity Improve Financial Firms' Risk Oversight, 70 SMU L. REV. 153, 202 (2017) (surveying empirical evidence on gender diversity and finding that gender diversity improves risk management outcomes).


20. Ramirez, supra note 18, at 109-10 (“[Businesses] need ... policies that assure that business organizations truly embrace diversity rather than pursue policies of tokenism or tacit exclusion. The point is that diversity must be properly managed.”). See also Rachel F. Moran, Of Doubt and Diversity: The Future of Affirmative Action in Higher Education Symposium: Meeting the Challenge of Grutter: Affirmative Action in Twenty-Five Years, 67 OHIO ST. L.J. 201, 208 (2006) (“Tokenism is the enemy of diversity.”).

21. See, e.g., Yves R.F. Guillaume et al., Harnessing Demographic Differences in Organizations: What Moderates the Effects of Workplace Diversity?, 38 J. ORGAN. BEHAVIOR 276,
scholars questioning the value of diversity frequently do not note the difference between well-managed diversity and tokenism.22

Thus, for example, those firms that achieve “Diversity Elite” status from Fortune magazine’s assessment of those with the best diversity practices outperform firms not in the Diversity Elite, according to a study published in 2015.23 Prior research found that “firms recognized by Fortune magazine for highly effective diversity management practices experience initial shareholder gains thereby suggesting competitive advantages consistent with the resource-based view of the firm.”24 The 2015 study expanded upon this prior finding by expanding its assessment to all levels of firm diversity and investigating the channels by which firm value is enhanced. The study concluded:

Having a diverse group of employees from different ethnic groups is likely to enhance the firm’s ability to identify unmet customer needs, develop more creative products or services, uncover new distribution strategies, build stronger relationships with key stakeholders, and make better firm level decisions among a host of other factors that drive firm performance. For those firms already engaging in actions that foster diversity, our findings shed some light on how ethnic diversity at different levels of the organization is more important within certain contexts as it may allow a firm to tap into varying sources of value creation stemming from innovation.25

This essay, therefore, proceeds upon the basis that unlocking the benefits of diversity requires attention to the best diversity practices for managing cultural diversity in a specific context—the provision of legal services to the publicly traded firm and the management of ethics and compliance risk implicit in that context.

Scholars long ago recognized that cultural diversity operates to positively influence compliance and ethics.26 These long-standing empirical findings also

22. Rhode and Packel do recognize the distinction. Rhode & Packel, supra note 18, at 377 (questioning empirical evidence regarding enhanced financial performance associated with diverse boards but recognizing that well-managed diversity may nevertheless prove beneficial).


24. Id. at 193 (citing V.K. Pandey et al., The Relationship between Shareholder Wealth Effects, Diversity, and Publicity as a Marketing Strategy, 33 J. ACAD. MARKETING SCI. 423 (2005)).

25. Id. at 210.

26. See, e.g., William A. Weeks et al., The Effects of Gender and Career Stage on Ethical Judgment, 20 J. BUS. ETHICS 301, 310-11 (1999) (“It appears that an influx of more females into the work force might improve the ethical environment based on how ethical problems are perceived..."
enjoy support from a corollary finding: women and ethnic minorities approach risk differently. As the authors of one study stated:

[O]ur survey revealed that men rate a wide range of hazards as lower in risk than do women. This result is consistent with gender differences found previously in many studies. Our survey also revealed that whites rate risks lower than do nonwhites. Nonwhite females often gave the highest risk ratings. The group with the consistently lowest risk perceptions across a range of hazards was white males.

Business management scholars identify numerous potential benefits arising from a diverse workforce, many of which logically support more effective legal representation for firms. This essay focuses exclusively upon benefits in terms of legal compliance and reputational risk.

Most recently, a series of studies demonstrated the benefits of senior management diversity in terms of the Great Financial Crisis. Superior risk management paid off during the financial crisis. Essentially, senior
management teams with greater cultural diversity succumbed to the risks posed during that crisis to a lesser extent than non-diverse senior management teams.\textsuperscript{35} Risk mismanagement played a central role in the Great Financial Crisis.\textsuperscript{36} The powerful lesson from the world of financial and managerial scholarship for corporate America in general is this: well-managed cultural diversity pays (in terms of shareholder wealth maximization) through superior management of compliance, ethics and other risks.

The different approach women and minorities take to issues relating to risk also leads to more ethical behavior and legal compliance.\textsuperscript{37} Thus, gender and ethnic diversity in the boardroom leads to higher levels of corporate transparency.\textsuperscript{38} According to one recent study, female CEOs exercise more conservativism with respect to accounting issues.\textsuperscript{39} Another study found that

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\textsuperscript{35} Laura St. Claire et al., \textit{Braving the Financial Crisis: An Empirical Analysis of the Effect of Female Board Directors on Bank Holding Company Performance} 1 (Office of the Comptroller of the Currency, Economics Working Paper No. 2016-1, 2016), https://www.occ.gov/publications/publications-by-type/occ-working-papers/2016-2013/wp2016-1.pdf ("We conclude that during the financial crisis, controlling for financial and board governance characteristics, BHCs with at least three female directors braved the crisis better, significantly outperforming BHCs with fewer female directors, as measured by Tobin's Q.").

Our research contributes to the discussion of optimal board governance by exploring the relationship between a critical mass of women on BHC boards of directors and performance. During the financial crisis, controlling for financial and board governance characteristics, BHCs with at least three women on their boards braved the crisis better, significantly outperforming BHCs with fewer female directors. This conclusion contrasts with the results over the 21-year span. Over this longer period, the performance of BHCs with at least three female directors was not statistically different than that of BHCs with fewer female directors, and BHCs with at least two female directors on average showed significantly lower performance.


\textsuperscript{36} See Kristin N. Johnson & Steven A. Ramirez, \textit{New Guiding Principles: Macroprudential Solutions to Risk Management Oversight and Systemic Risk Concerns}, 11 \textit{UNIV. ST. THOMAS L.J.} 386, 426 (2014) ("Recent proposals for large financial firms from the Fed and the OCC herald a potential revolution in corporate governance ... [but] these corporate governance-oriented reforms are too weak to stem the tidal wave of enterprise risk and systemic risk that risk management failures at [public] firms create.").

\textsuperscript{37} Social scientists theorize that women approach ethics differently based upon gender socialization. \textit{See} Leslie Dawson, \textit{Ethical Differences Between Men and Women in the Sales Profession}, 16 \textit{J. BUS. ETHICS} 1143, 1143-44 (1997) ("This theory holds that general and nearly universal differences that characterize masculine and feminine personalities are formed in childhood and are incontrovertible; these in turn differentially shape the work-related interests, concerns, and values of the sexes.").


\textsuperscript{39} \textit{See} Simon S.M. Ho et al., \textit{CEO Gender, Ethical Leadership, and Accounting Conservatism}, 127 \textit{J. BUS. ETHICS} 351, 366 (2015) ("Regardless of the measure of ... conservatism, we find consistent evidence that companies led by female CEOs report earnings more conservatively.").
female board representation leads to fewer accounting restatements. The authors suggest that this finding is consistent with the disruption of groupthink and superior group decision-making dynamics. Similarly, at least with respect to Chinese firms, when there is more gender diversity on the board, there is less securities fraud. Women are more likely to speak out against unethical behavior and blow the whistle on misconduct than their male counterparts. Finally, empirical evidence shows that African-Americans, Latinos, Asian-Americans, and whites have different ethical sensitivities.

These differences in ethical sensibilities and risk sensitivities suggest that business would be well-advised to diversify in order to assure that its behavior conforms to the ethical expectations of all its key constituencies—labor pools, supply chains, capital sources, consumers, and communities. This point benefits from empirical support that shows firms with more diverse boards achieve higher corporate social responsibility ratings. Diversity gives firms the key to unlocking the prodigious value of an enhanced reputation and ethicality by assuring that no important constituency finds the firm’s conduct repellent and that the firm’s conduct fully acclimates itself to the full spectrum of ethical

40. See Lawrence J. Abbott et al., Female Board Presence and the Likelihood of Financial Restatement, 26 ACCT. HORIZONS 607, 626 (2012) (“Using a matched-pair sample of restatement and control firms, we conducted conditional logistic regressions comparing the characteristics of restatement and control firms. Briefly, we find a significant reduction in the likelihood of financial restatement and the presence of at least one female board director.”). As always, the authors acknowledge issues related to possible omitted variables and the direction of causation. Id. at 626-27.

41. See id. at 611-13, 627 (“We draw upon the groupthink and group dynamics perspectives to suggest that female board presence creates an atmosphere in which viewpoints that may disrupt group cohesion are communicated and considered, and the pace of decision-making is slowed.”).

42. See Douglas Cumming et al., Gender Diversity and Securities Fraud, 58 ACAD. MGMT. J. 1572, 1573 (2015) (“Our evidence shows that gender diversity reduces the likelihood of being in our fraud sample and reduces the severity of the fraud.”).

43. See Iris Vermeir & Patrick Van Kenhove, Gender Differences in Double Standards, 81 J. BUS. ETHICS 281, 290 (2008) (“[W]omen are systematically less tolerant towards unethical actions compared to men.”); Joyce Rothschild & Terance D. Miethe, Whistleblower Disclosures and Management Retaliation: The Battle to Control Information About Organization Corruption, 26 WORK & OCCUPATIONS 107, 113 (1999) (“Internal whistle-blowers were far more likely to be women than men.”).

44. See, e.g., Costas Hadjicharalambous & Lynn Walsh, Ethnicity/Race and Gender Effects on Ethical Sensitivity in Four Sub-Cultures, 15 J. LEGAL ETHICAL & REG. ISSUES 119, 128 (2012) (offering an empirical analysis of ethical variations across different racial/ethnic and gender groups).

45. See Maretno Harjoto et al., Board Diversity and Corporate Social Responsibility, 132 J. BUS. ETHICS 641, 642 (2015) (“Firms could suffer both monetary and reputational losses from failing to align management’s interests with those of their stakeholders. Effective stakeholder management is a critical requirement for firm success.”).

46. Given that group dynamics and decision making vary depending on the background of the individuals serving on corporate boards, a diverse group of directors brings a different knowledge base, sets of experiences, and perspectives on society to group decision making. As a result, diversity increases the board’s ability to recognize the needs and interests of different groups of stakeholders as reflected on CSR performance. Id.
sensitivity within its operating environment. Therefore, in-house counsel should advise senior management to diversify the firm to the maximum extent possible (including the adoption of policies aimed at inclusiveness of diverse voices) for the purpose of insuring greater compliance and higher ethical standards. Naturally, this search for greater levels of cultural diversity should include the corps of outside counsel representing the firm.

The true potential of ethnic and gender diversity to assure superior risk management and compliance capabilities is just now beginning to emerge from the world of social science. For example, no proponent of well-managed diversity would advocate mere tokenism as a mechanism of unleashing the full benefits of cultural diversity. Instead, diversity management requires that diverse experiences represent a critical mass in any group setting to allow a robust exchange of ideas and perspectives. Thus, studies regarding the impact

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47. See Stephen Bear et al., The Impact of Board Diversity and Gender Composition on Corporate Social Responsibility and Firm Reputation, 97 J. BUS. ETHICS 207, 207 (2010).

Corporate reputation refers to “publics’ cumulative judgment of firms over time. Research has demonstrated a broad range of benefits associated with a positive reputation. A good reputation enhances a firm’s ability to attract job applicants. Reputation affects employee retention as employees who feel their company is well regarded by external groups have higher job satisfaction and a lower intention to leave their organizations. A positive reputation also enhances corporate branding, enabling a company to use its brand equity to launch new products and enter new markets. Reputation can positively affect financial performance, institutional investment, and share price. A study by Mercer Investment Consulting indicated that 46% of institutional investors consider environmental, social, and corporate governance when making investment decisions, and McKinsey reports that institutional investors will pay a premium (12-14%) for well-governed companies.

Id. (internal citations omitted).


49. As I highlighted in a seminal article on diversity in business in 2000:

Many corporations, most notably Texaco, have suffered dire consequences from an inability to manage diversity. These instances, however, do not detract from the central thesis of this article that businesses are using diversity as a competitive advantage in order to maximize profits, and that the legal system should accommodate, encourage and respond positively to this new paradigm of viewing diversity as a strength. Instead, these instances highlight the need for policies that assure that business organizations truly embrace diversity rather than pursue policies of tokenism or tacit exclusion. The point is that diversity must be properly managed.

Steven A. Ramirez, The New Cultural Diversity and Title VII, 6 MICH. J. RACE. & L. 127, 140 (2000). Indeed, the concept that diversity must be embraced through policies and the pursuit of best practices highlights the fundamental distinction between affirmative action (which focuses on bringing traditionally excluded groups into organizations and institutions) and diversity policies (which seek to further an organizations institutional mission through broadening cognitive perspectives and experiences). Id. at 109-24.

50. As Rachel Moran states:
of a critical mass of diverse voices are just now beginning to show how diversity in the boardroom leads to greater innovation and firm performance—and such studies focusing on critical mass are limited by the fact that few boards include a critical mass of women, much less ethnic minorities. Many prior studies of the impact of diversity in the world of business or finance necessarily fail to deal with the confounding effects of tokenism. Ethnic and racial diversity is so rare that virtually no empirical studies can assess the effect a critical mass of senior managers has on financial performance and risk management.

In terms of compliance and ethics, one key lesson to draw from the emerging best practices of diversity management is that diverse voices must be empowered to give voice to their diverse perspectives and experiences. Critical mass plays a critical role in assuring that such voices are heard and that tokenism does not operate to isolate or silence workers or managers with different voices.

Tokenism is the enemy of diversity. For groups previously excluded from access to legal education, feelings of alienation and isolation not only retard academic achievement but also silence the very voices that are the building blocks of a diverse law school. A critical mass of these students is necessary to achieve a truly diverse student body that contributes to the robust exchange of ideas.


51. See Jasmin Joecks et al., Gender Diversity in the Boardroom and Firm Performance: What Exactly Constitutes a "Critical Mass?" 118 J. BUS. ETHICS 61, 70 (2013) ("[W]e find evidence for a U-shaped link between gender diversity on the board and firm performance ... [a board] needs a critical mass of women ... to realize the advantages a more diverse board may offer. We find this critical mass to be in the range of about 30% female representation ... "); Mariateresa Torchia et al., Women Directors on Corporate Boards: From Tokenism to Critical Mass, 102 J. BUS. ETHICS 299, 312 (2011) ("[O]ur results show that the boards' contribution to ... innovation is higher in boards with 'at least three women': boards where women directors reach critical mass.").

52. See Corinne Post & Kris Byron, Women on Boards and Firm Financial Performance: A Meta-Analysis, 58 ACAD. MGMT. J. 1546, 1556 (2015) (reviewing 140 studies and finding that gender diversity on boards enhances financial performance and accounting earnings in nations that have strong investor protections and enjoy high gender parity but that "less than a handful" of studies measure diversity through the lens of "critical mass").

53. See Lissa Lamkin Broome et al., Does Critical Mass Matter? Views from the Boardroom, 34 SEATTLE U. L. REV. 1049, 1078 (2011) ("[V]ery few of our texts address the issue of a critical mass of minority (as opposed to female) directors. In part, this reflects the simple fact that it is hard to find a public company with three or more minority directors.").

54. As the federal financial regulators put it:

Many entities promote the fair inclusion of minorities and women in their workforce by publicizing employment opportunities, creating relationships with minority and women professional organizations and educational institutions, creating a culture that values the contribution of all employees, and encouraging a focus on these objectives when evaluating the performance of managers.

perspectives and experiences. Therefore a key element for the successful management of diversity requires a manifest value for embracing diversity at the highest level of a firm. Policies and procedures that are transparent, enforced and openly available will determine if a firm benefits from diversity management or suffers from diversity mismanagement. Unfortunately, episodes of diversity mismanagement still plague otherwise successful firms, even as of early 2017.

In light of the above-referenced empirical evidence, in-house counsel can and should proceed more aggressively with respect to the issue of enhanced cultural diversity within their firms, and the corporate counsel they hire and supervise. More diverse firms will curtail unnecessary reputational and compliance risk through the heterogeneous perceptions of risk and ethics that a diverse workforce and senior management manifestly bring to the table. Further, heterogeneous work groups will naturally resist groupthink and affinity bias, and induce superior group performance. Diversity can enhance sound risk management, which itself is a proven mechanism for superior financial performance. This all adds up to superior performance, and superior compliance and ethics outcomes.

55. See supra notes 20, 50, and 51 and accompanying text.
57. “Entities are encouraged to disclose their diversity policies and practices, as well as information related to their assessments, to ... the public.” Id. at 33,024.
59. See Abbott et al., supra note 40, at 627 (suggesting that increased firm diversity will inhibit or eliminate the risks of groupthink).
60. See Sheen S. Levine et al., Ethnic Diversity Deflates Price Bubbles, 111 PROC. NAT'L ACAD. SCI. 18524, 18525 (2014) (explaining the correlation between ethnic homogeneity and lower likelihood of price bubbles).
62. See Vincent Aebi et al., Risk Management, Corporate Governance, and Bank Performance in the Financial Crisis, 36 J. BANKING & FIN. 3213, 3224 (2012) (finding that banks with a more independent risk management function outperformed other banks during the financial crisis).

The fact is that if you want to build teams or organizations capable of innovating, you need diversity. Diversity enhances creativity. It encourages the search for novel information and perspectives, leading to better decision making and problem solving. Diversity can improve the bottom line of companies and lead to unfettered discoveries and breakthrough innovations. Even simply being exposed to diversity can change the way you think. This is
II. THEORIZING OPTIMAL RISK MANAGEMENT IN COMPLIANCE AND ETHICS

In the preceding section of this essay, I highlighted overwhelming empirical evidence that different racial groups and genders hold different perspectives on risk, ethics, and compliance. In this section, I highlight how, thus far, legal reformers have not been able to construct legal and regulatory approaches that sufficiently encourage counsel to speak out against inappropriate conduct that ultimately harms their client to a very significant degree. Then I highlight how cultural diversity, when properly managed, can empower corporate counsel to voice dissent to costly misconduct.

It appears that counsel representing the public corporation in America suffers from certain impediments in assuring a rational risk management function insofar as ethics and compliance are concerned. The Enron series of corporate scandals proved that widespread financial fraud could and would occur under the legal and regulatory frameworks prevailing during that era. Congress gave the SEC power to promulgate, essentially, federal rules of professional responsibility in response to this reality. More specifically, in Section 307 of the Sarbanes-Oxley Act, Congress authorized the SEC to impose new rules for governing the obligation of counsel appearing before the Commission to report financial wrongdoing.

not just wishful thinking: it is the conclusion I draw from decades of research from organizational scientists, psychologists, sociologists, economists and demographers.

Id.

64. For one, counsel is required by professional responsibility mandates to maintain client confidences. Lisa Bank & Matthew LaGarde, Can General Counsel and Compliance Officers Blow the Whistle?, CORP. COMPLIANCE INSIGHTS (Oct. 7, 2016), http://www.corporatecomplianceinsights.com/attorneys-cos-blow-the-whistle/ (“Attorneys face the most difficult issues in deciding whether to blow the whistle, as they are subject to the ethical rules of the jurisdiction in which they practice. These ethical rules vary among the 50 states and the District of Columbia, but they are generally uniform regarding the obligation to protect client information and communications.”).


66. Section 307 provides:

[T]he Commission shall issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers, including a rule—

(1) requiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and

(2) if the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another committee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

The SEC exercised its power to promulgate new rules applicable to counsel appearing before the Commission on behalf of public firms. The Commission’s new rules broke new ground by mandating that counsel report certain unlawful behavior up the corporate ladder, and monitor senior management’s response to the report. The SEC’s rules also authorized counsel to report certain information out to the SEC. Before the SEC’s initiative, lawyers for publicly traded firms held the same obligation as all attorneys for reporting wrongdoing: they could report putative wrongdoing only if they “know” of misconduct; and they could report wrongdoing out of the corporation only if it posed a risk of serious bodily harm or death.

The SEC also created a safe-harbor for counsel if a firm created a Qualified Legal Compliance Committee (“QLCC”) to receive counsel’s reports of wrongdoing. The SEC required QLCCs to include at least one member of the issuer’s audit committee; to include two or more other outside directors; and, to hold power to receive and investigate reports of potential misconduct. If an attorney reports evidence of potential wrongdoing to a QLCC, then the attorney need not further monitor the response of senior management. Thus, the SEC created incentives for firms to create QLCCs.

Nevertheless, very few publicly-traded firms created QLCCs. According to the most recent data, only a small percentage of firms adopted a QLCC within the first years after the SEC’s promulgation of the rule creating QLCCs. Thus, the SOX innovations failed to prompt more whistleblowing from corporate counsel—in-house or otherwise.

68. 17 C.F.R. § 205.3(b) (2003).
69. 17 C.F.R. § 205.3(d).

When the Sarbanes-Oxley Act and Rule 205 were enacted, ABA Model Rule 1.6 generally prohibited an attorney from disclosing information relating to the attorney-client relationship. The rule permitted disclosure only in limited circumstances where such revelations were “reasonably necessary to prevent reasonably certain death or substantial bodily harm,” were required by law or court order, were necessary to comply with ethics rules, or were for purposes of establishing a lawyer’s fees or self-defense.

Id.

71. 17 C.F.R. § 205.2(k).
72. Id.
73. 17 C.F.R. § 205.3(c).
74. “Over 96% of the companies listed on the New York Stock Exchange ... have not established QLCCs.” Robert Eli Rosen, Resistances to Reforming Corporate Governance: The Diffusion of QLCCs, 74 FORDHAM L. REV. 1251, 1252 (2005). “Resistance to the QLCC may be understood as resistance to a monitoring board.” Id. at 1282.
75. See RAMIREZ & RAMIREZ, supra note 13, at 99, 207 (reviewing all whistleblowers emerging in the run up to the financial crisis and only identifying one lawyer, Alayne Fleischmann, who blew the whistle long after the crisis). See also Burton, supra note 13.
The Dodd-Frank Act of 2010 only marginally changed this reality. While not materially altering the duties imposed upon corporate counsel, the Dodd-Frank Act did create incentives for corporate counsel to blow the whistle on illegal conduct. Nevertheless, in terms of corporate counsel acting to stem unlawful or unethical behavior, Dodd-Frank simply does not move the ball forward in any meaningful way.

This essay cannot catalogue all of the reasons why counsel seemingly resists putting a stop to questionable activities and transactions. Instead, the article proceeds on the premise that the current legal and regulatory framework governing corporate counsel does not operate to protect shareholders, the investing public, and American capital markets. Nothing demonstrates this point better than the near universal silence of the corporate counsel on Wall Street in the face of pervasive unlawful misconduct, not to mention widespread business practices of dubious ethicality. Despite these flaws, many corporate counsels want to help their firms comply with law and engage in more ethical behavior. “There is decent evidence that individual lawyers—at least on some level—hunger to be more ethical and want to assume a greater role in counseling clients to observe the law.”

Even beyond mere legal compliance, shareholders may also suffer losses due to reputational risks arising from unethical conduct. With respect to both compliance and ethics, the heterogeneous perspectives on risk, compliance, and ethics arising from culturally diverse voices can at least help in-house counsel define and manage ethical concerns. Specifically, by elaborating the extent of information the firm may access to assess conduct, the firm can operate beyond law in a way that fully acclimates it to important populations, such as consumers. If the ethical and compliance screening function firm mirrors the cultural diversity of its labor, consumer, and capital pools, it will hold sufficient insights to avoid alienating such suppliers and consumers through legal but


77. See, e.g., Jennifer M. Pacella, Advocate or Adversary? When Attorneys Act as Whistleblowers, 28 GEO. J. LEGAL ETHICS 1027, 1054 (2015).

78. See generally Sung Hui Kim, Naked Self-Interest? Why the Legal Profession Resists Gatekeeping, 63 FLA. L. REV. 129 (2011) (examining the arguments against the lawyer-gatekeeper and outlining the resistance from the profession to such a role).

79. Id.

80. Ramirez, Back to the Drawing Board, supra note 11, at 362.

81. Hui Kim, supra note 78, at 159 (“[T]hree cognitive processes—self-interested motivation, internalization of managers’ views as a product of cognitive dissonance, and indifference to abstract shareholders—explain why lawyers resist gatekeeping duties.”).

82. Id.

83. Ramirez, Back to the Drawing Board, supra note 11, at 360-61.

84. Johnson et al., supra note 15, at 1816 (“Diversity gives ... firms the key to unlocking the prodigious value of an enhanced reputation and ethicality by assuring that no important constituency finds the firm’s conduct repellent and that the firm’s conduct fully acclimates itself to the full spectrum of ethical sensitivity within its operating environment.”).

85. See generally id.
ethically dubious conduct.\textsuperscript{86} In short, under this approach, the diverse cultural perspectives within the firm’s pools of suppliers and consumers defines its ethical compass and conscience, and the imperative of the firm to acclimate itself optimally to these constituents, in order to maximize shareholder value, sets its course of ethicality.

Basing the acclimation of the firm to cultural diversity should also operate to provide the firm with a standard of ethicality more rigorous than the definition of ethicality that has too often prevailed in the past.\textsuperscript{87} Under current law, most firms subjected a proposed course of conduct to the ethics screen of only white males, usually relying upon senior managers to supervise the work of underlings with little or no external checks.\textsuperscript{88} CEOs in particular played a key role in determining appropriate conduct, and they are nearly all white males.\textsuperscript{89} A culturally diverse screening would necessarily add in the ethics sensitivities of women and different ethnic groups.\textsuperscript{90} These additional filters would create a new set of standards that firms would abide by to cater to the sensibilities within its key constituencies.\textsuperscript{91} A diverse screening of conduct would lead to better information about ethical, reputational, and compliance risk than a homogenous screening, and could operate to protect shareholders from the adverse consequences of such risks.\textsuperscript{92}

The next section of this essay articulates an approach based upon the firm’s manifest need to acclimate itself as positively as possible to the varying

\textsuperscript{86} Ramirez, \textit{Back to the Drawing Board}, supra note 11, at 352.

\textsuperscript{87} Unfortunately, the guidance of ethicists to business leaders in terms of concrete decision-making lacks clarity and fails to communicate standards of conduct to such leaders in a meaningful way. See John Hasnas, \textit{The Normative Theories of Business Ethics: A Guide for the Perplexed}, 8 BUS. ETHICS Q. 19, 19 (1998) ("[One] charge ... frequently lodged against the practical utility of business ethics as a field of study concerns the apparent failure of communication between the theorist and the business practitioner. Critics of the discipline often point out that business ethicists are usually academics, and worse, philosophers, who speak in the language of abstract ethical theory. Thus, they are accused of expressing their ideas in terms of 'deontological requirements,' 'consequentialist considerations,' 'the categorical imperative,' 'rule utilitarianism,' 'the hedonistic calculus,' 'human flourishing' and other locutions that are essentially meaningless to the ordinary business person who possesses little or no philosophical training.") (internal footnote omitted).

\textsuperscript{88} See generally Ramirez, \textit{Back to the Drawing Board}, supra note 11, at 365.

\textsuperscript{89} RICHARD ZWEIGENHAFT & G. WILLIAM DOMHOFF, \textit{The New CEOs: Women, African American, Latino, and Asian American Leaders of Fortune 500 Companies}, at xii, xxiii (paperback ed. 2014) (showing that women and minorities now lead only about 10% of the Fortune 500 as CEOs and hold only about 25% of directorships despite comprising nearly 64% of the population).

\textsuperscript{90} See supra notes 26-44 and accompanying text.

\textsuperscript{91} See supra notes 26-44 and accompanying text.

\textsuperscript{92} Note that under a more hollow approach to shareholder wealth maximization would hold that businesses would hold no ethical obligations. Fairly or not, this can be traced to Milton Friedman who stated: "[T]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud." See Hasnas, supra note 87, at 22. I argue that shareholder wealth maximization requires ethical and compliance efforts beyond mere legal compliance to minimize losses and maximize gains from firm reputation. Thus, the acclimation theory offered herein remains anchored in shareholder wealth maximization even while suggesting conduct beyond mere compliance with law.
perspectives of its key constituencies, as a means for enabling in-house counsel to guide their firms to superior ethical and compliance outcomes.

III. THE CORPORATE REALITY AND OVERCOMING CULTURAL HOMOGENEITY

This section seeks to show that in-house counsel can use cultural diversity to get a more refined assessment of the appropriateness of a given course of conduct or transaction. Cultural diversity may also mitigate affinity bias and groupthink, thereby breaking down social barriers to speaking out against unlawful and unethical conduct.

Cultural diversity gives the firm more elaborate insights into how key constituencies will react to a given course of conduct or transaction. Therefore, in-house counsel should seek to arm the corporation with a structure that assures proposed conduct and transactions that raise any potential ethical or compliance issues are subjected to a culturally diverse group, with the charge that they report on any ethical or compliance issues. I proposed a structure capable of functioning in this way in 2010, building upon the SEC’s QLCC innovation. Given management’s disinclination to establish such committees, in-house counsel could suggest a compliance and ethics advisory council to work with in-house counsel to subject questionable practices to more careful screening from the group, including screening from culturally diverse perspectives. If in-house counsel determines that a given course of conduct or transaction warrants further inquiry, in-house counsel could arrange for outside counsel to weigh-in.

By insisting that firms representing the corporation also hire and promote culturally diverse attorneys, in-house counsel could assure that any opinion of

93. Information elaboration drives all elements of the benefits of diversity. Of course, cognitive diversity and information elaboration is not limited to diverse cultural perspectives or experiences associated with race or gender. See generally Lubomir P. Litov et al., Lawyers and Fools: Lawyer-Directors in Public Corporations, 102 GEO. L.J. 413 (2014) (finding that lawyer-directors add diversity to the board, give the board access to more elaborate information, and thereby add value).

94. Some firms already seek greater diversity in their ranks. Kenneth Davis, Consulting Giant Demands Diversity among Outside Counsel, GEN. COUNSEL CONSULTING, http://www.gconsulting.com/articles/120135/73/Consulting-Giant-Demands-Diversity-among-Outside-Counsel/ (last visited Apr. 6, 2017) (“To bring more diversity into its law department, Accenture has developed orientation and mentoring programs for its minority and women recruits. The orientation program allows new hires to meet with management-level attorneys as well as representatives from each practice area.”).

95. Ramirez, Back to the Drawing Board, supra note 11, at 362-63.

96. See Rosen, supra note 74, at 1282.

97. Naturally, in-house counsel should refer thorny compliance and ethics issues to the law firms sporting the greatest cultural diversity. Many in-house counsel already recognize this need. See Rick Palmore, A Call to Action: Diversity in the Legal Profession (Oct. 2004), http://www.acc.com/vl/public/Article/loader.cfm?csModule=security/getfile&pageid=16074&recorde=1 (citing Diversity in the Workplace: A Statement of Principle, 9 BUS. L. TODAY 41 (1999-2000)) (“As Chief Legal Officers, we hereby reaffirm our commitment to diversity in the legal profession. Our action is based on the need to enhance opportunity in the legal profession and our recognition that the legal and business interests of our clients require legal presentation that reflects the diversity of our employees, customers and the communities where we do business.”).
counsel itself benefit from the same multicultural screening, which is bound to be more comprehensive in its assessment, and more rigorous in its screening.\textsuperscript{98} Again, in-house counsel can take the lead in making sure its outside firms assure the diverse voices within outside firms enjoy sufficient space and stature to voice concerns.\textsuperscript{99} In-house counsel holds a unique ability to influence major law firms to embrace cultural diversity more aggressively.\textsuperscript{100} In-house counsel can thus diversify both the corporations they serve, as well as the law firms they hire and supervise.

If counsel can persuade management to impose some substantial structure for the purpose of screening conduct for reputational risk, and the firm has fully diversified this function, in-house counsel has essentially secured the highest level of scrutiny for the most dubious practices.\textsuperscript{101} As such, the corporation is now positioned to make decisions with the highest level of elaborated information regarding how the course of conduct will be received within the firm's key labor, capital, and consumer pools.\textsuperscript{102} The firm can now weigh potential unethical and unlawful behavior that presents risk to the firm's reputation.

This information elaboration thereby remains anchored in the value of shareholder wealth maximization.\textsuperscript{103} After all, what senior management team would press ahead with a course of conduct that could impose severe reputational costs in an important part of its key constituencies?\textsuperscript{104} The fact that the assessment of ethicality or compliance repercussions of a given business practice would have been so comprehensively vetted within the firm, and by outside counsel in appropriate cases, would presumably shield an in-house attorney from much more patent risks and career threats in being forced to blow the whistle alone, without the support of other culturally diverse voices.\textsuperscript{105}

Further, because cultural diversity disrupts groupthink and affinity bias, in a way that triggers deeper thinking and more thorough preparation, this may well

\textsuperscript{98} Some high-profile firms also already do this. See, e.g., Davis, supra note 94 ("Accenture, one of the world's largest consulting firms, is pushing its outside counsel to add more diversity to their firms and is prepared to drop those who don't make efforts to improve.").

\textsuperscript{99} Id. ("Additionally, each firm had to describe how successful it was at retaining its minority lawyers, whether it had any recruiting or retention programs for them, and how it measured the effectiveness of such programs. Accenture shared the aggregate data with outside counsel, showing them how they compared with their peers and encouraging firms to share ideas and best practices.").

\textsuperscript{100} Id. ("In its meetings with the 15 firms during 2006, Accenture discussed how well each had done in relation to the others. Each firm also developed an individual action plan in consultation with the company.").

\textsuperscript{101} This follows logically from the differential approaches of women and people of color to ethics and risks. A diversified screening process will assure conduct clears all relevant screens. See supra Part II.

\textsuperscript{102} See supra notes 37-44 and accompanying text.

\textsuperscript{103} See supra Part II.

\textsuperscript{104} It may well prove to be a material fact that senior management ignored such an ethics screening process, requiring public disclosure under the federal securities laws. THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 489 (6th ed. 2005).

\textsuperscript{105} See supra notes 5-6.
cause superior outcomes across a range of considerations transcending ethics and compliance risks. The firm would thus benefit financially, not just from diminished reputational costs, legal costs, and regulatory concerns, but even more directly through superior decision making. This accords itself with abundant evidence linking the embrace of cultural diversity to superior financial performance and cognition gains.

Essentially, in-house counsel can use enhanced cultural diversity to create a more refined filter for pursuing shareholder primacy. This shifts responsibility from a single in-house attorney to an institutional organ within the firm. In appropriate cases, regulators may even insist on such an organ. Counsel can arm the firm with appropriate policies and procedures to assure the full benefits of cultural diversity accrue to the corporation and that the firm approach optimal diversification. In sum, well-managed cultural diversity gives in-house counsel a key tool to enhance reputational risk management.

The more that in-house counsel can encourage cultural diversity within the firm, and within its primary providers of legal advice, the less likely it is to engage in conduct that any important constituencies are likely to find repellent. The goal should be to diversify the firm to the same extent as its labor pool, consumers, and capital providers. At the same time, given the empirical record of enhanced cultural diversity within well-managed firms, it appears unlikely that

106. See supra notes 7, 20 & 23.
107. More recent examples of these costs include the fiascos at Volkswagen and Wells Fargo. Geoff Colvin, The Wells Fargo Scandal Is Now Reaching VW Proportions, FORTUNE (Jan. 26, 2017, 2:52 PM), http://fortune.com/2017/01/25/the-wells-fargo-scandal-is-now-reaching-vw-proportions/ (“I thought it would be a long time before a corporate scandal got bigger and worse than the Volkswagen emissions-cheating mess. I still think that, but almost every day the Wells Fargo situation makes me wonder if it might soon surpass even VW in overall awfulness.”).
108. Phillips, supra note 64.
109. While many scholars eschew the very concept of shareholder primacy within the public corporation, I maintain that the problems associated with the public firm usually do not arise from shareholder primacy, but from the perversion of the concept into CEO primacy. See Steven A. Ramirez, Lessons From the Subprime Debacle: Stress Testing CEO Autonomy, 54 ST. LOUIS U. L.J. 1, 52 (2009) (“Excessive CEO autonomy played a central role in the subprime mortgage crisis.... Specifically, corporate governance law in the United States permits CEOs of public firms to generate current income to enhance their own compensation without regard to risk. The cost of this excessive autonomy reaches into the tens of trillions of dollars.”).
110. The concept that CEOs are not always the repository for ultimate control of every corporate function and that corporate law scholars need to think harder about mechanisms for optimizing the institutional role of the CEO within the modern public corporation is not new. See Steven A. Ramirez & Betty Simkins, Enterprise Wide Risk Management and Corporate Governance, 39 LOY. U. CHI. L. J. 571, 588 (2008) (“A CEO-centric model of risk management [will] not lead to suboptimal results.... Risk management can be enhanced through diversity in perspectives and expertise. Therefore, the CEO is not the optimal center for all risk management, even if CEO input is essential for any kind of meaningful risk management.”). This proposed institutional design would assist in-house counsel in managing ethics and compliance risk, natural arena to displace CEO autonomy.
111. See Johnson et al., supra note 15, at 1851-67 (reviewing the power of financial regulators to impose new institutional limits on senior management of errant financial firms).
112. See supra notes 19, 21, 54, 56 & 57.
more cultural diversity within any firm will materially harm financial performance.

CONCLUSION

The empirical evidence demonstrates that America’s diverse population holds differing approaches to ethics, compliance, and risk. In-house counsel can harness these differences to assure that a firm’s conduct comports with, and acclimates to, the differing ethical and compliance sensibilities and sensitivities within the general population, and within key corporate constituencies such as labor, investor and consumer pools. Essentially, in-house counsel can assure that any proposed business conduct or transaction clears all relevant filters—not just the traditional white male filter—and advise senior management accordingly. Counsel wishing in good faith to stem misconduct would hold an additional tool: feedback from within the firm, or from outside counsel, that diverse perspectives found the proposed course of business or transaction objectionable. Only management uninterested in acclimating the firm to the cultural diversity within key corporate constituencies would proceed in the face of such feedback.

While cultural diversity alone will not compensate for the flawed legal frameworks at play in this arena, it may arm in-house counsel with tools that can deliver superior outcomes more often than traditionally has been the case. At the very least, enhanced cultural diversity embedded in a screening function within the firm, that is armed with the tools for a heterogeneous assessment of the most dubious firm practices, provides the firm with an objective and rigorous basis for determining the ethicality and costs of a given practice or course of conduct. The firm will at least find itself well-equipped to acclimate itself to its key constituencies and that should stem the costliest corporate misconduct. Given the macroeconomic catastrophe that followed the collapse of the financial sector in 2008 and 2009, improvement may prove easy.