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Economics of Corporate Gatekeeping: Roles and Responsibilities of Multiple Gatekeepers

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Abstract

This paper primarily identifies the corporate gatekeeper and their roles and responsibilities and shows examples of economic costs resulting from corporate gatekeeping failures. The gatekeeper responsibilities in the various sectors of the economy such as public, private, financial, legal, accounting and corporate – Board of Directors, regulatory agencies – Government commissions have been identified. Failure in rightful responsibility in dealing with the conflict of interest by the gatekeepers posted in the running of corporate affairs causes corporate failures, and corporate scandals crossing the limit of corporate business practice, regulatory and legal and ethical and moral limit cast massive cost to the business and finally to the whole economy. They are sharing liability among corporate gatekeepers has been discussed for distribution of the cost of damage. The damages cause reputational loss to every professional involved in the gatekeeping process and finally cost severe damage to the county's economic branding and credit rating as a whole. All limitations cannot be overcome in one attempt. Instead, it is gradual. There should be a priority in the regulatory professionals' selection process by fixing a proper eligibility criterion – bench marks, allowing them to work based on the prevailing rules, in the absence of the rules that should be framed for execution responding to the changed situation. The paper presents a summary, conclusion and recommendation for further research.

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Introduction

Descriptions of gatekeepers typically focus on their ex-ante role. One standard definition of gatekeeper is a reputational intermediary who provides verification or certification services to investors. Another one is needed before a transaction can close [Geoffrey C. Hazard Jr. & Angelo Dondi, (2004)]. Gatekeepers, however, also engage in ex-post monitoring designed to uncover misconduct after it occurs, initiate an investigation, and report the misconduct or take enforcement measures. Also, many gatekeepers perform an advisory role concerning structural or regulatory issues regarding a transaction without necessarily providing verification, certification, or approval. Such advisors are gatekeepers, too, because we expect them to advise a client to avoid illegal conduct. Taking these considerations into account, a gatekeeper is defined in this paper as a person or firm that provides verification or certification services or that engages in monitoring activities to cabin illegal or inappropriate conduct in the capital markets.

The expanding interest in positive incentives for capital market gatekeepers dovetails with a broader and older trend in the regulation literature. It reflects a philosophical shift from traditional deterrence-oriented strategies toward more cooperative and rewards-oriented systems to promote compliance. This approach joins market and regulatory accountability mechanisms described using various terms such as cooperative compliance, interactive compliance, responsive regulation, collaborative governance and cooperative implementation. An essential inspiration for this shift is empirical psychological evidence suggesting that positive incentives may be more likely to promote desired behaviour than harmful threats.

Law's preoccupation with liability design is understandable since lawyers have a comparative advantage in liability design. Designing reward systems may seem beyond the law's scope or lawyers' competence. A lawyer might expect that if rewards programs are productive, market participants will design and implement them. While this seems correct, two qualifications are relevant. First, non-market impediments can frustrate implementing good ideas, as where gatekeepers fear that demonstrating the capability to perform a task will expose them to liability. Second, contemporary financial reporting occurs in a complex setting that combines free market innovation with considerable regulatory

limitations. The combination may prevent otherwise appealing contractual innovations from gaining traction. If so, lawyers—and legal scholars—may have the capacity to spark ideas that markets can test and implement. In that spirit, this Article introduces the possibility of going beyond liability to design rewards for effective gatekeepers.

The theoretical concept of Gatekeepers —

Varieties of third-party assistance in accessing capital markets exist. The following considers the attributes and distinctions among those usually described as "gatekeepers" and "whistle-blowers" and then considers some that partake of attributes of each (called hybrids below). Gatekeepers work with an enterprise to correct misreporting before it occurs. They do so by threatening to withhold the support necessary to complete a report or consummate a transaction. Gatekeepers can deny access to capital markets (Peter C. Kostant, *Breeding Better Watchdogs: Multidisciplinary Partnerships in Corporate Legal; 2000)*. So gatekeepers are "intermediaries who provide verification and certification services to investors" by pledging their professional reputations—and, by withholding such support, block admission through the gate (Erik F. Gerding, 2006). Law's gatekeeper approach always imposes a monitoring duty but not necessarily a reporting duty: eventual discovery exposes the gatekeeper to liability for the primary violation, not merely a remedy for non-reporting. Even so, the gatekeeper approach is intended to give professionals regulatory incentives to prevent misreporting [(HARV. L. REV. 2227, 2245 (2004)]. Most gatekeepers are paid for their services by the enterprises that retain them; all have stated duties whose breach exposes them to legal liability.

Gatekeepers include auditors and attorneys, who work directly with and essentially inside the enterprise. Auditors attest to financial statement assertions under duties established by statute and articulated in professional codes of performance (SEC Order (April 25, 2003). Lawyers advise on transaction design and disclosure. Lawyers often determine whether senior executives can sign disclosure documents and provide written legal opinions or memoranda concerning transactions' legality and compliance with the law. Duties of both auditors and lawyers arise initially from the contract but include a regulatory overlay of professional standards.

Gatekeepers also include other transaction participants, such as investment banks and sometimes rating agencies, plus professionals working apart from transactions outside the enterprise, such as securities analysts and possibly stock exchanges and mutual funds (Lawrence A. Cunningham; 2004). Unlike auditors and lawyers, these gatekeepers do not typically act under any legal duty or vouch

for the enterprise's statements about itself. Instead, they provide their own statements, such as a securities rating or a buy-sell recommendation. Professionals within this broad conception of gatekeepers thus differ significantly. Roles vary with product or service type and the information its buyers and users receive. Also varying are what professionals attest to or certify, such as fairness of financial statement assertions, the legality of a securities issuance, quality of a debt instrument. Accordingly, also varying are all other public policy aspects of their respective performance, including requirements, expectations, capacities, incentives and appropriate legal liability for failure. Indeed, auditors and attorneys reside at opposite ends of a gatekeeping spectrum: both put reputations and liability on the line, but lawyers take leading roles in deal design and disclosure preparation. In contrast, auditors take backup roles in reviewing and testing disclosure. Despite these differences, the term gatekeeper has assumed day-to-day usage, not only in the academic literature but in official regulatory pronouncements (Coffee, 2000).

The liability of corporate gate keepers for misstatements and omissions in the public disclosure documents of their corporate clients is an intensely controversial issue. After each wave of corporate upheaval, scrutiny invariably descends on business transactions and on apparent errors in corporate disclosures that accompanied them. Professionals often find themselves implicated for having facilitated transactions and having failed to avert disclosure errors. The focus on lawyers' conduct in the controversial merger of Bank of America and Merrill Lynch is a case in point (N.Y. Times, Oct. 13, 2009). Known as gatekeeper liability, the liability of professionals for the wrongs of their clients is premised on the ability of professionals to monitor and control their clients' conduct.

The imposition of potential liability provides powerful incentives for professionals to exercise their ability to monitor and control, thereby deterring corporate wrongs. While the professions oppose the notion of themselves as gatekeepers in line with the Report of the New York City Bar Association (2007), referring to the "lively debate" regarding whether lawyers should perform a gatekeeping function and insisting that lawyers act solely in the interests of their clients and do not owe any duty to the investing public. The U.S. federal securities laws nonetheless impose on their liability for the disclosure failings of their clients, and an extensive literature has developed to consider what liability rules would induce gatekeepers to take optimal precautions to deter client wrongs [John C. Coffee, Jr., (2004) Frank Partnoy, (2004); Assaf Hamdani, (2003); Reinier H. Kraakman, (1986) Frank Partnoy, Barbarians (2001)]

Corporate Gatekeeper Liability Theory

In the 1980s, Reinier Kraakman published two articles that expanded on the concept of "gatekeeper liability," which he defined as liability imposed on private parties who can disrupt misconduct by withholding their support from wrongdoers [Reinier H. Kraakman, (1986); Reinier H. Kraakman, (1984)]. This support—which might include a specialized good, service, or form of certification that is essential for a wrongdoer to succeed– "is the 'gate' that the gatekeeper keeps." Actual gatekeeper liability is designed to enlist the support of outside participants in the firm when controlling managers commit offences; the first requisite for gatekeeper liability is an outsider who can influence controlling managers to forgo offences. These professionals are less likely to risk their reputations over fraudulent or suspicious transactions as outsiders to the firm. Kraakman identified outside directors, accountants, lawyers, and underwriters as potential targets for gatekeeper liability strategies: they each have access to information about firm misconduct, they already perform a private monitoring service on behalf of the capital markets, and they face incentives that differ from those of managers (that is, they are likely to have less to gain and more to lose from firm misconduct than inside managers). Like other liability regimes, gatekeeping imposes costs; Kraakman examines whether legal rules can induce gatekeepers to prevent misconduct at an "acceptable price." After outlining possible costs of a gatekeeping model, Kraakman suggests ways to adjust these costs, such as limiting penalties that gatekeepers face for breach of duty or selecting prescribed duties for gatekeepers to undertake.

Finally, Kraakman canvasses other enforcement strategies and concludes that gatekeepers' response to misconduct by withholding support has significant advantages over other third-party enforcement duties. For Kraakman, legal duties should be imposed on intermediaries to act as gatekeepers in specific markets due to defects in the ability of parties to contract or ascertain the reputation of different intermediaries. Stephen Choi, however, argues that Kraakman's argument "fails to take into account the impact of different screening accuracies in the market, the incentives of intermediaries to invest in accuracy, the ex-ante response of producers to the possibility of certification, and potential market defects [Stephen Choi, (1998]." Choi argues that "gatekeeper liability is too heavy-handed a response" and instead advocates for less intervention through a system of self-tailored liability, a regime where "lawmakers may allow intermediaries to choose for themselves the specific duties that they will be held accountable . . .."

More recently, John C. Coffee, Jr. has popularized Kraakman's concept in the aftermath of Enron and other corporate scandals. Coffee has blamed such scandals on the failure of gatekeepers, who, he asserts, allowed management to engage in

fraud [John C. Coffee, Jr., (2001-2002); John C. Coffee, Jr., (Oxford University Press 2006)]. Coffee has defined gatekeepers as independent professionals who act as reputational intermediaries, providing verification or certification services to investors. Gatekeepers have less incentive to deceive; therefore, the market views gatekeepers' assurances as more credible. Their credibility also stems from the fact that gatekeepers pledge their reputational capital. Theoretically, a gatekeeper would not sacrifice the reputational capital built over many years of performing services for a single client or a modest fee. However, there are instances where reliance on gatekeepers may be misplaced, such as: where there is a sudden decline in the deterrent threat facing gatekeepers, and they are thus more willing to take risks; where greater inducements are offered to gatekeepers to breach their duties; or where specific market scenarios lessen injury to a gatekeeper's reputation [John C. Coffee Jr (Columbia Law Sch. Ctr. for Law and Econ., Working Paper No. 191, 2001)].

Coffee's list of gatekeepers are auditors, credit rating agencies, securities analysts, investment bankers, and securities lawyers. Coffee concludes that the creation of excessive liability might cause the market for gatekeeping services to fail; instead, he advocates a shift towards stricter liability standards with a ceiling on gatekeeper liability adequate to deter misconduct. Whereas Coffee's proposed system is essentially regulatory, Frank Partnoy advocates a contractual system based on a percentage of the issuer's liability [Frank Partnoy Research Paper Series, Paper 5, 2004)]. Under Partnoy's proposed regime, gatekeepers would be strictly liable for an issuer's securities fraud damages under a settlement or judgment [Frank Partnoy (2001)]. Although gatekeepers would not have available to them due diligence defense, they could limit their liability by agreeing to and disclosing a percentage limitation on the scope of their liability. Authors such as Larry Ribstein oppose mandatory personal liability for professionals as a relatively ineffective way to encourage professional firms to perform their duties to clients and others [Larry Ribstein (2004)]. Ribstein argues that this liability is based on "an attenuated notion of responsibility and unrealistic assumptions about firm members' ability to monitor."

Furthermore, he suggests, imposing personal liability on professionals may increase agency costs between professionals and their clients, affect professional firm size, structure and scope; and reduce the desirable liability of the firm. Concerning auditors, Lawrence Cunningham prescribes a framework that uses financial statement insurance as an alternative to financial statement auditing backed by auditor liability [Richard W. Painter (2004). In his proposed framework, companies could opt for either model, subject to investor approval. Financial statement insurance policies would cover damages arising from audit

failure— damages due to financial misstatements that auditors did not discover— replacing auditor and issuer liability.

In the broader context of the regulation of gatekeepers, Richard Painter stresses the balancing act that this type of regulation entails [Richard W. Paint (2004)]. Gatekeeper regulation, he argues, is pointless if it impairs information flow to gatekeepers: "Any improvement in gatekeeper response to the risk that comes from these rules has to be weighed against potential reduction in gatekeeper information and consequent impairment of gatekeeper evaluation of risk." In order to optimize the regulation of gatekeepers, he suggests that experimentation with divergent rules—for example, American and European rules for auditor and lawyer intervention, rather than convergence of legal rules, will facilitate the learning process.

Objective and Structure of the paper

Corporate gatekeeping functions as the government's mechanism to save the public interest entities from corporate failures. This paper examines the functions and operating procedures of different corporate gatekeepers within the financial system to operate an efficient capital market. To carry out an evaluation of the ideal roles and responsibilities of different gate keepers with differentiation of independent and dependent and sharing their respective liabilities in performing their professional assignments. To achieve the objectives, this paper is divided into nine sections. *Section one* begins with the adverse economic impact resulting from the corporate gatekeeping failures. Although the principles of corporate governance rules and procedures, code of ethics, rules of business binding for the individual and multiple gatekeepers from both independent-dependent ones fail to noncompliance, adversely affects the entity's business. The cumulative results of all gatekeeping failures cast massive costs to the market and national economy are described in this section. Information on the adverse effects of corporate scandals in the 21st century destroying huge shareholder equity is reported in this section. The common causes associated with corporate governance scandals are documented in this section. Different corporate gatekeeping failures are explained. Chronology stresses accounting scandals, legal opinion failures, audit firm failures, and estimates economic impact has been discussed.

The political-regulatory-market reaction, civil procedures and damage awards, damage caused by conflict-of-interest have been identified. Results of corporate failures and bank scandals resulting from the failures of corporate gatekeeping are discussed, including scenario Bangladesh. *Section two* discusses the existence corporate gatekeeper. This section highlights the transaction cost analysis, existence of multiple gate keepers, gate keeping webs and presents a

brief history of corporate governance. *Section three* presents the differentiating roles and responsibilities of multiple gatekeeper's-such as independent and dependent: auditors, security analyst's attorneys, security underwriters, and IPO managers and valuation firms. *Section four* presents the regulatory regime of gatekeeper liabilities as of the directors, lawyers, auditors, credit rating agencies, financial analysts, and underwriters.

Section I: Economics of Corporate Scandals

Corporate Scandals

A corporate scandal is assumed as a set of questionable, unethical, and/or illegal actions that a person or persons within a corporation engage in (Source: *Business Dictionary. com*). The text following was extracted from the company's annual report that probably would be very well assessed by market agents regarding its corporate governance practices. It is, though, an extract of Lehman Brothers Annual Report 2007, the U.S. investment bank that collapsed just a few months after the release of this document. Like so many other similar cases, Lehman's case illustrates how companies that were role models in their top management practices collapsed due to different reasons such as wrong business decisions, risk management problems or fraud.

A corporate entity continues to be committed to industry best practices for corporate governance. The Board of Directors consists of ten members. Except for our CEO, all of our directors are independent. The audit, nominating, and corporate governance, finance and risk, and compensation and benefits committees are exclusively composed of independent directors. The Audit Committee includes a financial expert as defined in the SEC's rules. The board holds regularly scheduled executive sessions in which non-management directors meet independently of management. The board and all its committees each conduct a self-evaluation at least annually. Last year, overall director attendance at board and committee meetings was 96%. We have an orientation program for new directors. The corporate governance guidelines also contemplate continuing director education arranged by the company. The Corporate Entity Code of Ethics is published on our website. They have designed their internal control environment to put appropriate risk mitigates in place. The Corporate have a global head of risk management and a global risk management division that is independent. The company's management assessed the effectiveness of our internal controls. Based on our assessment, they believe that the company's internal controls are adequate over financial reporting. These controls have also

been considered adequate by the independent auditors. Corporates also sponsor several share-based employee incentive plans.

Alexandre Di Miceli da Silveira (2013) School of Economics, Management and Accounting, the University of São Paulo in his working paper titled 'Corporate Scandals of the 21st Century: limitations of mainstream corporate governance literature and the need for a new behavioural approach' The number of corporate scandals associated with corporate governance problems in the first decade of this century is extensive. Wikipedia website, for instance, provides a list of more than 75 corporate scandals throughout this period. Their economic relevance is enormous. Table 1 below lists 23 selected high profile corporate scandals that, together, have destroyed an estimated US$750 billion of their shareholders' equity.

The initial argument is that governance scandals are the direct outcome of a standard set of fourteen interrelated factors detailed ahead, such as excessive concentration of power, ineffective board of directors, the passivity of investors, failure of gatekeepers, poor regulation, lack of the proper ethical tone at the top.

The central point is, nevertheless, is to argue that the root of the problem lies in the way the corporate governance concept has been internalized by most companies, investors and academics worldwide. Based on the work of orthodox economists (Jensen and Meckling, 1976; Fama and Jensen, 1983), corporate governance has been widely grounded on the agency theory perspective, which is concerned with creating ways to motivate one party (the "agent"), to act on behalf of another (the "principal"). As a result, the good governance of a business, a very complex subject, has been reduced to a mere set of incentive and control mechanisms to induce agents (managers) to make decisions in the best interests of their principals (shareholders).

The limitation of the debate to the theoretical framework of agency theory has at least two fundamental problems. First, the dissemination of corporate governance as a mere set of rewards and punishment mechanisms to be implemented in order to induce behaviours has left business leaders free to treat this complex and intrinsically human subject as a mere check- list of recommended practices to be fulfilled in order to be well perceived by the outside stakeholders. The Lehman Brothers' case is just one among several similar scandals in which there was a discrepancy between the essence of good governance–companies where decisions are made in their best long-term interest and in which people comply with the rules– and the way the governance practices were shown externally.

Second, agency theory–formulated almost forty years ago– is based on the *homo economicus* premise. This concept has been proved to be a minimal portrait

Table 1: Corporate scandals in the 21st Century destroying shareholders' equity US$751 b

#	Company	Country	Year	Estimated losses for share holders17	Did it involve fraud?	What happened?
1	Enron	USA	2001	$60 billion	YES	Accounting fraud, inflation of assets debt hidden in unique purpose entities kept off the balance sheet.
2	Xerox	USA	2001	$2 billion	YES	The company improperly booked nearly $3 billion in revenues between 1997 and 2000, leading to an overstatement of earnings of nearly $1.4 billion.
3	Adelphia	USA	2002	$2.5 billion	YES	The Rigas founding family borrowed $2.3 billion from the company that was not reported on its balance sheets. The firm overstated results by inflating capital expenses and hiding debt.
4	Tyco	USA	2002	$1 billion	YES	The Chairman and CEO Dennis Kozlowski and former CFO Mark H. Swartz were accused of diverting about $600 million from the company.
5	WorldCom	USA	2002	$186 billion	YES	The company overstated cash flow by booking $11 billion in operating expenses as capital expenses. It also gave about $400 million to its Chairman and CEO, Bernard Ebbers, in off-the-books loans.
6	Vivendi	France	2002	$13 billion	Uncertain	The company was accused of misleading information about its Ebitda growth and liquidity in its public filings and releases in order to meet targets in 2001. It accumulated huge debts due to an aggressive acquisition strategy prompted by its powerful CEO Jean Marie Messier.
7	Royal Ahold	Nether-lands	2003	$2 billion	YES	The company has overstated its profits by more than $1 billion as well as kept billions in debt off its balance sheet. It also pursued a failed aggressive strategy of acquisitions resulting in significant losses for its shareholders.
8	Parmalat	Italy	2003	$3 billion	YES	The company collapsed in 2003 with $14 billion in off-balance-sheet debts hidden in unique purpose entities, in what remains Europe's biggest bankruptcy.
9	Royal Dutch Shell	Netherlan ds / UK	2004	$1 billion	YES	The company has overstated its proved oil reserves by 23 per cent, resulting in profits being exaggerated by $276 million and profits embellished by an additional $156 million.

Continue

#	Company	Country	Year	Estimated losses for share holders17	Did it involve fraud?	What happened?
19	Madoff	USA	2008	$65 billion	YES	Founder and CEO Bernard Madoff confessed that a Ponzi scheme had been running for decades at his asset management company, resulting in losses for his approximately 4,800 investors.
20	Satyam	India	2009	$3 billion	YES	Ramalingam Raju, Chairman and founder of Satyam (India's fourth-largest IT company), sent a letter to both the board of directors and to the country's regulator in which he confessed that the company had inflated its revenues by 76% and its profits by 97% in the previous year.
21	Panamericano	Brazil	2009	$2.5 billion	YES	The bank, which had successfully made its IPO just two years earlier, announced a hole of about $ 2.0 billion on its balance sheet, about 2.5 of its equity and half of its total assets.
22	BP	UK	2010	$45 billion	NO	An explosion at Deepwater Horizon, a drilling rig in the Gulf of Mexico connected to a well owned by the oil company BP, led to the largest accidental oil spill in history and the death of 11 workers. The firm has put aside $20 billion for compensation for damages incurred by victims of the spill. With previous safety incidents at the company, BP was accused of negligence regarding its operational risk management practices.
23	Olympus	Japan	2010	$7 billion	YES	The company concealed losses by paying $687 million to advisers on acquisitions. The company is also accused of siphoning another $1.5 billion through offshore funds.
	Total Estimated losses			$751 billion		

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of human nature by numerous recent researches (presented ahead) in different fields such as sociology, psychology, neuroscience, behavioural economics. Specifically, these studies have consistently shown that people are not rational, exclusively selfish, or interested in breaking rules depending on their relative economic benefits, as predicted by the *homo economicus* concept. Since this accumulated knowledge in other fields cannot be ignored, a rethink of the corporate governance concept is needed in light of these works.

As a result, it is argued that a new behavioural approach to corporate governance focusing on the psychological aspects of human beings inside organizations shall emerge. This new approach should be based on at least three main components ignored by agency theory: 1) the systematic focus on the mitigation of cognitive biases in managerial decisions; 2) the continuous fostering of employee and executives awareness towards the promotion of unselfish cooperative behaviours; and, 3) the reduction of the likelihood of frauds and other dishonest acts through new corporate strategies developed after a deeper understanding of their psychological motivations. This new approach does not dismiss the importance of incentive and control mechanisms recommended by the agency theory. Such mechanisms remain relevant but should not be seen as sufficient for well-governed companies. Expanding the corporate governance literature beyond agency theory towards a behavioural approach should be seen as crucial to reducing the emergence of new corporate scandals in the coming years.

Information on corporate governance relates with different fields of knowledge that provide complementary theoretical frameworks to agency theory, such as the kinds of literature of trust in organizations (Noreen, 1988; Mayer et al. 1995; Schoorman et al., 1996; Bower et al., 1997; De Dreu et al., 1998; Zaheer et al., 1998; Becerra and Gupta, 1999 and 2003; Sundaramurthy and Lewis, 2003; Cadwell and Karri, 2005), stewardship theory (Donaldson and Davis, 1991; Davis et al., 1997; Arthurs and Busenitz, 2003; Hernandez, 2012), and intrinsic motivation (Deci and Ryan, 1985; Frey and Jegen, 2001; Fehr and Falk, 2002; Kolev et al. 2012). Trust literature criticizes agency theory's pessimistic assumptions about human behaviour pointing out that this approach precludes trust and cooperation, crucial elements for successful organizations. It argues that corporate agents may show an attitude of trust and cooperation depending on contextual and personal factors, therefore not always behaving selfishly. Overall, this literature considers trust as an efficient mechanism to maximize the principal's utility. Stewardship theory views executives as "stewards" of the organization who are motivated to act responsibly based on an assumption of trust. It considers that managers obtain greater utility when developing a

collaborative approach than when behaving selfishly, primarily when they identify with organizational values and goals. The literature on motivation points out that non- pecuniary motives shape human behaviour, including intrinsic pleasure arising from work, the desire to obtain social approval and the sense of reciprocation. It also contends that extrinsic rewards such as those emphasized by agency theory may undermine the role of intrinsic rewards on motivation and increase an agent's opportunistic behaviour.

The above also fits in an emerging line of research that criticizes agency theory's simplistic and inflexible assumptions about human behaviour and the narrowness of its predictive validity (Tirole, 2002; Charreaux, 2005; Van Ees et al., 2009; Cuevas-Rodríguez et al., 2012; Martin et al., 2012; Wiseman et al., 2012). Overall, these works call for new approaches toward corporate governance by widening the agency concept through a behavioural perspective. It is believed that this paper contributes to this literature by prescribing three specific areas of concentration for the emergent behavioural approach to corporate governance based on an analysis of corporate scandals from the earlier 21st century and the fragilities of the homo economicus premise evidenced by numerous recent works.

Cost of Corporate Gatekeeping Failures

After the stock market peaked in August 2000 and the technology-driven bull market ended, the financial markets started a steady decline. A short national recession began in March 2001 and ended in November 2001, with the gross domestic product declining until the fall. The market plunge deepened in the wake of the September 2001 terrorist attacks; however, a rally began in late 2001 as economic data showed that the national economy was not falling into a deeper recession. In early 2002 the economic prospects appeared to be improving, and a USA Today survey of investment strategists published in January of that year showed expectations of a modest market gain for the year. The markets did continue to rise until March 2002, by which point the public focused on the numerous evolving corporate scandals that then drove markets sharply lower through the summer. During this period—between mid-March and mid-July—the markets declined by almost 28 per cent. Part of this decline was related to data showing that neither corporate profitability nor the overall economy made a significant comeback. Just as markets appeared to be stabilizing at the end of 2002, they began to fall again due to concerns over a war with Iraq which led to the third consecutive year of market declines as the Standard and Poor's 500 Stock Index fell more than 20 per cent for the year. Concerns about military conflict continued to pull the market down in early 2003, although markets rallied briefly in March during the early stages of the war. As the war progressed, markets

Table 2: Common causes associated with corporate governance scandals

Type of Cause associated with Corporate Scandals	Common Cause	This cause is manifested when…
Fundamental Cause	Excessive concentration of power	Corporate decisions tend to come from the single views of specific individuals without the appropriate counterbalances.
	Ineffective Board of Directors	Boards do not satisfactorily perform their role of monitoring managers and providing the right strategic direction.
	Passivity of investors	Investors do not correctly exercise their role as active shareholders and end up wrongly rewarding firms with unsustainable practices by inflating their stock prices.
	Failure of gatekeepers	Reputational intermediaries such as auditors, stock analysts, credit rating agencies, attorneys, investment banks and consultants who pledge their reputational capital to vouch for information that investors cannot verify fail in their duties.
	Poor Regulation	Poor or non-existent regulation allows the occurrence of governance problems.
Mediating Cause	Illusion of success of the business	People inside and outside the organization come to believe that the company is an absolute success, ignoring contrary evidence and generating a feeling of invincibility.
	Internal atmosphere of greed and arrogance	An internal atmosphere of euphoria and hubris creates an inner sense of superiority to people outside the company.
	Lack of ethical tone at the top	Leaders fail to promote high ethical standards within their organizations, not treating the issue as something essential and priority.
	Corporate governance seen as a marketing tool	The company seeks to meet the check-list of recommended governance practices without embracing the theme at its core prior to the emergence of the scandals. Three corporate statements below provide examples of this: *"Enron Values: 1) Communication: we must communicate. 2) Respect: we treat others as we would like to be treated ourselves. 3) Integrity: We work with customers and prospects openly, honestly and sincerely. 4) Excellence: We are satisfied with nothing less than the very best in everything we do." – Enron Annual Report 2000. "We are committed to being an active and responsible member of every community where we do business worldwide, and we have set the goal of becoming best-in-class in corporate governance, business practices, sustainability and corporate citizenship… We believe that an unwavering commitment to corporate responsibility is vital for our long-term success. That is why we go to great lengths to balance business, ethical, environmental and social concerns… We are committed to financial transparency, compliance with the financial*

Continue

Type of Cause associated with Corporate Scandals	Common Cause	This cause is manifested when…
		Reporting requirements of German stock corporation law and U.S. Capital market regulations, and open communication with our shareholders. Binding rules and guidelines ensure that our dealings with business partners are ethical and adhere to all relevant legal requirements" – Siemens Annual Report 2005."Safety, people and performance, and these remain our priorities. Our number one priority was to do everything possible to achieve safe, compliant and reliable operations. Good policies and processes are essential, but, ultimately, safety is about how people think and act. That is critical at the front line, but it is also true for the entire group. Safety must inform every decision and every action. The BP operating management system turns the principle of safe and reliable operations into reality by governing how every BP project, site, operation and facility is managed. Our work on safety has been acknowledged inside and outside the group" – BP Report 2008.
Immediate Cause	Overexpansion of the business	Excessive growth of the company in the years immediately preceding the governance problems, primarily via acquisitions, contribute to the scandal.
	Biased strategic decisions	Unintentionally bad top-level strategic decisions are made due to cognitive biases such as overconfidence, groupthink, information cascades.
	Inflated Financial Statements	The company intentionally publishes doctored financial statements, often inflating its profits or hiding its debts.
	Weak internal controls	The main components of a sound internal control system are missing, such as an adequate control environment, effective risk management and control activities.
	Inadequate compensation system	A compensation system too aggressive and too connected to short-term goals substantially contributes to governance problems.

became more volatile in response to the daily reports of battlefield successes and failures. Nevertheless, by mid-April, the military conflict appeared to be winding down, and the financial markets had begun to advance again, although there were fluctuations due to fiscal developments, domestic economic news, and corporate profitability reports. The markets were still moving forward in mid-August 2003.

In general, the performance of the financial markets contributes to the wealth of individuals. Increased wealth occurs with the sale of a financial instrument and the realization of a capital gain. However, increases in the financial markets create unrealized paper wealth that makes individuals feel better off—known as the "wealth effect." Over time, as households feel they have more money, they gradually increase their consumption to match their perceptions. Likewise, as households see their financial holdings become less valuable, they feel poorer and modify their spending behaviour to deal with this contingency. Because approximately half of all households in the own nation stock, movements in the financial markets can significantly impact actual and perceived wealth and significantly affect consumer spending, representing about two-thirds of the national economy. Rising financial markets also increase the ease with which businesses can access capital and lower the cost. It, in turn, helps fuel growth in business investment, which is necessary for continued productivity growth and expanding the economy. Thus, both businesses and consumers benefit from rising financial markets.

Corporate Gatekeeping failure resulting from Accounting Scandals

All was not rosy as the three decades starting from the 1940s through to the 1960s came to a close. Threatening clouds began to form over the accounting profession in the middle and latter 1960s. A dark shadow was cast on the accountancy profession during this time. Financial scandals burst onto the scene, raising questions about the performance of auditors. Trailing in the wake of these scandals, auditors found themselves as defendants in several highly publicized lawsuits.

Moreover, the accounting profession lost its prized authority to pronounce on generally accepted accounting principles (GAAP) to an independent body, with unfortunate ramifications for the vitality of professional discourse. Accounting scandals are political and/or business scandals that arise with disclosing financial misdeeds by trusted executives of corporations or governments. Such misdeeds typically involve complex methods for misusing or misdirecting funds, overstating revenues, understating expenses, overstating the value of corporate assets or underreporting the existence of liabilities, sometimes with the cooperation of officials in other corporations or affiliates.

In public companies, this type of "creative accounting" can amount to fraud, and investigations are typically launched by government oversight agencies, such as the Securities and Exchange Commission (SEC) in the United States. It is reasonably easy for a top executive to reduce the price of his/her company's stock – due to information asymmetry. The executive can accelerate accounting of expected expenses, delay accounting of expected revenue, engage in off-balance-sheet transactions to make the company's profitability appear temporarily poorer, or promote and report severely conservative (e.g. pessimistic) estimates of future earnings. Such seemingly adverse earnings news will be likely to (at least temporarily) reduce share price. (This is again due to information asymmetry since it is more common for top executives to do everything they can to window dress their company's earnings forecasts). There are typically very few legal risks to being 'too conservative' in one's accounting and earnings estimates.

A reduced share price makes a company an easier takeover target. When the company gets bought out (or taken private) – at a dramatically lower price – the takeover artist gains a windfall from the former top executive's actions to surreptitiously reduce share price. It can represent tens of billions of dollars (questionably) transferred from previous shareholders to the takeover artist. The former top executive is rewarded with a golden handshake for presiding over the fire sale that can sometimes be in the hundreds of millions of dollars for one or two years of work. It is nevertheless an excellent bargain for the takeover artist, who will tend to benefit from developing a reputation of being very generous to parting top executives.

Similar issues occur when a publicly held asset or non-profit organization undergoes privatization. Top executives often reap tremendous monetary benefits when a government-owned or non-profit entity is sold to private hands. Just as in the example above, they can facilitate this process by making the entity appear to be in financial crisis – this reduces the sale price (to the purchaser's profit) and makes non-profits and governments more likely to sell. It can also contribute to a public perception that private entities are more efficiently run, reinforcing the political will to sell off public assets. Again, due to asymmetric information, policy makers and the general public see a government-owned firm that was a financial 'disaster' – miraculously turned around by the private sector (and typically resold) within a few years. Top executives cause not all accounting scandals. Often managers and employees are pressured or willingly alter financial statements for the personal benefit of the individuals over the company. Managerial opportunism plays a significant role in these scandals, and public accountants become part of these scandals through a certification process. For example, managers who would be compensated more for short-term results would

report inaccurate information since short-term benefits outweigh long-term pension obligations.

Estimating the Economic Impact of Corporate Gatekeeping Failures

In the January 1999 Federal Reserve Bulletin, "Aggregate Disturbances, Monetary Policy, and the Macro economy: The FRB/U.S. Perspective," an article examined the relationships utilized in the Federal Reserve's national econometric model. This model is used to simulate the economy's behaviour after potential fiscal, and monetary policy actions are taken to respond to different disturbances in the national economy. The relationships cover a broad range of topics and issues, including employment, earnings, prices of goods and labour, and the cost of capital, rates of return on investment, consumption, behavioural adjustments, and expectations. Understanding the behaviour of the financial markets is a significant concern, as they affect rates of inflation, the resources available for business investment, the wealth of consumers, and their spending patterns. The relationships affecting household wealth and spending are critical, as consumer spending accounts for about two-thirds of economic activity in the nation. Paper covering the economic impact of accounting scandals (New York State Office of the State Comptroller 2003) examples of the model in use, such as evaluating the impact of interest rate changes, shifts in productivity, changes in the value of the dollar, increases in income, or price shocks. One of the conditions explored involves. Reserve economists found that a sustained 20 per cent decline in stock market wealth ultimately reduces the GDP by 0.4 per cent after one year, 0.8 per cent after two years, 1 per cent after three years, and 2.1 per cent after ten years. The declines in GDP occur because of reduced consumption spending (with the reduction in personal wealth) and less investment (with the rise in the cost of capital).

These relationships between stock market wealth and the economy were applied in an August 2002 policy brief by the Brookings Institution entitled *Cooking the Books: The Cost to the Economy*. As the financial markets deteriorated with continued news of corporate scandals and accounting irregularities through early 2002, the brief's authors sought to estimate how much the scandals contributed to a decline in wealth, and in turn, economic output (for a discussion of the authors' methodology. The decline caused by the scandals would be part of the much more significant decline in wealth—and reduction in GDP—arising from the financial markets' decline from its 2000 peak.

Using the Federal Reserve's relationships between changes in stock market wealth and the economy, Brookings estimated that the corporate scandals would reduce the GDP by $35 billion, or 0.34 per cent, in the first year, assuming that

Company	Year	Audit Firm	Country	Notes
Associated Electrical Industries, after being acquired by General Electric Company plc	1967		United Kingdom	
Pergamon Press	1969		United Kingdom	
Lockheed Corporation	1976		United States	
Nugan Hand Bank	1980		Australia	
ZZZZ Best	1986		United States	Ponzi scheme run by Barry Minkow
Barlow Clowes	1988		United Kingdom	Gilts management service. £110 million missing
MiniScribe	1989		United States	
Polly Peck	1990		United Kingdom	
Bank of Credit and Commerce International	1991		United Kingdom	
Phar-Mor	1992	Coopers & Lybrand	United States	mail fraud, wire fraud, bank fraud, and transportation of funds obtained by theft or fraud
Informix Corporation	1996	Ernst & Young	United States	
Sybase	1997	Ernst & Young	United States	
Cendant	1998	Ernst & Young	United States	
Waste Management, Inc.	1999	Arthur Andersen	United States	Financial misstatements
Micro Strategy	2000	PWC	United States	Michael Saylor
Computer Associates	2000	KPMG	United States	Sanjay Kumar
Lernout & Hauspie	2000	KPMG	Belgium	Fictitious transactions in Korea and improper accounting methodologies elsewhere
Xerox	2000	KPMG	United States	Falsifying financial results
One.Tel	2001	Ernst & Young	Australia	
Amir-Mansour Aria	2011	IAO (Audit organization) and other Audit firms	Iran	Business Loans Without Putting any Collateral and financial system
Bank Saderat Iran	2011	IAO (Audit organization) and other Audit firms	Iran	financial transactions among banks and Getting a lot of Business Loans Without Putting any Collateral
Enron	2001	Arthur Andersen	United States	Jeffrey Skilling, Kenneth Lay, Andrew Fastow

Contination

Company	Year	Audit Firm	Country	Notes
Swissair	2001	Price water house Coopers	Switzerland	
Adelphia	2002	Deloitte & Touche	United States	John Rigas
AOL	2002	Ernst & Young	United States	Inflated sales
Bristol-Myers Squibb	2002[20][26]	Price water house Coopers	United States	Inflated revenues
CMS Energy	2002[20][27]	Arthur Andersen	United States	Round trip trades
Duke Energy	2002[20]	Deloitte & Touche	United States	Round trip trades
Dynegy	2002	Arthur Andersen	United States	Round trip trades
El Paso Corporation	2002	Deloitte & Touche	United States	Round trip trades
Freddie Mac	2002	Price water house Coopers	United States	Understated earnings
Global Crossing	2002	Arthur Andersen	Bermuda	Network capacity swaps to inflate revenues
Halliburton	2002	Arthur Andersen	United States	Improper booking of cost overruns
Homestore.com	2002	Price water house Coopers	United States	Improper booking of sales
ImClone Systems	2002	KPMG	United States	Samuel D. Waksal
Kmart	2002	Price water house Coopers	United States	Misleading accounting practices
Merck & Co.	2002	Price water house Coopers	United States	Recorded co-payments that were not collected
Merrill Lynch	2002	Deloitte & Touche	United States	Conflict of interest
Mirant	2002	KPMG	United States	Overstated assets and liabilities
Nicor	2002	Arthur Andersen	United States	Overstated assets, understated liabilities
Peregrine Systems	2002	KPMG	United States	Overstated sales
Qwest Communications	2002	1999, 2000, 2001 Arthur Andersen 2002 October KPMG	United States	Inflated revenues

Contination

Company	Year	Audit Firm	Country	Notes
Reliant Energy	2002	Deloitte & Touche	United States	Round trip trades
Sunbeam	2002	Arthur Andersen	United States	Overstated sales and revenues
Symbol Technologies	2002		United States	Overstated sales and revenues
Tyco International	2002	Price water house Coopers	Bermuda	Improper accounting, Dennis Kozlowski
WorldCom	2002	Arthur Andersen	United States	Overstated cash flows, Bernard Ebbers
Royal Ahold	2003	Deloitte & Touche	United States	Inflating promotional allowances
Parmalat	2003	Grant Thornton SpA	Italy	Falsified accounting documents, Calisto Tanzi
HealthSouth Corporation	2003	Ernst & Young	United States	Richard M. Scrushy
Nortel	2003	Deloitte & Touche	Canada	Distributed ill-advised corporate bonuses to top 43 managers
Chiquita Brands International	2004	Ernst & Young	United States	Illegal payments
AIG	2004	Price water house Coopers	United States	Accounting of structured financial deals
Bernard L. Madoff Investment Securities LLC	2008	Friehling & Horo witz	United States	Massive Ponzi scheme.[44]
Anglo Irish Bank	2008	Ernst & Young	Ireland	Anglo Irish Bank hidden loans controversy
Satyam Computer Services	2009	Price water house Coopers	India	Falsified accounts
Lehman Brothers	2010	Ernst & Young	United States	Failure to disclose Repo 105 transactions to investors
Sino-Forest Corporation	2011	Ernst & Young	Canada-China	
Olympus Corporation	2011	Ernst & Young	Japan	*tobashi* using acquisitions
Autonomy Corporation	2012	Deloitte & Touche	United States	Subsidiary of HP

stock markets did not deviate significantly from their levels of July 19, 2002. This base estimate assumed that about 60 per cent of the 28 per cent decline in the stock market between March 19, 2002, and July 19, 2002, resulted from the corporate scandals. Using their alternate lower and upper interval assumptions about the amount of the market decline attributed to the corporate scandals (30 per cent and 90 per cent), the Brookings authors then estimated that the range of the economic impact of scandals could vary in the first year from a lower limit of $21 billion, or 0.2 per cent of the GDP, to an upper limit of $50 billion or 0.48 per cent of the GDP.

It is important to note that these estimates only represent the scandals' contribution to a decline in wealth and output. The declines in the financial markets due to the corporate scandals represent only part of the overall decline in the market since the end of the bull market in 2000. As noted earlier, the financial market decline between its August 2000 peak and its February 2003 low amounted to almost 44 per cent or 648 points. Looking at the cumulative impact of three years of stock market declines and using the Federal Reserve's relationships between wealth and economic output, we estimate that about $140 billion worth of GDP has been lost during this period. The corporate scandals represent a significant component of the lost output.

Brookings also looked at an alternate approach to check their estimates. Comparing the actual mid-2002 market performance with the expectations of Wall Street investment strategists as reported in a USA Today poll at the start of the year, Brookings found that the July 19 close was about 30 per cent below the mean projection for the survey. Applying their low, base, and high assumptions about the amount that the scandals contributed to the market decline, using the Federal Reserve relationships, they calculated an alternate impact on GDP in the range of $19 billion to $57 billion. Expectations for GDP growth in the national economy during 2002 diminished as the year progressed. The Blue Chip Economic Consensus Forecasts had plunged in the wake of the September 2001 terrorist attacks but were gradually recovering; they reached 2.8 per cent by May 2002. Amid rising public awareness of the corporate scandals and growing concerns that the economy may have stalled, these forecasts fell to 2.3 per cent in August 2002 and remained near there for the rest of the year. During that time, there was an equivalent drop in the forecast for 2003, which showed that the expected impact would continue into the following year. The 2003 outlook continued to drop over the remainder of the year as war worries began to build.

An important consideration about these estimates, emphasized in both the Federal Reserve and Brookings Institution papers, is that a decline in wealth must be maintained for an extended period to realise the projected impact on the

economy fully. To the extent that financial markets recover, they will again contribute to a gain in wealth. Over time, as businesses and consumers feel that the increase in wealth is genuine and not likely to reverse shortly, they will modify their behaviour toward increased consumption and investment. It would help diminish the long-term effect of the original decline in wealth.

Political and regulatory Reaction to the Corporate Gate Keeping Failures

The political and regulatory response to the scandals had two branches: criminal proceedings against companies and individuals accused of acting negligently or fraudulently in the past and legislative proceedings aimed at reducing the incidence of future negligence and fraud.

Criminal Proceedings: Criminal law is created, administered, and prosecuted by governments. In criminal law, defendants found guilty in securities cases can be punished with prison sentences, fines, asset seizures, or disbarment from practice. Additional costs borne by defendants include legal fees, reputation, loss of employment prospects, time, and stress on themselves and their families. The United States initiated criminal proceedings against a range of individuals and corporations involved in the accounting scandals.

Legislative Proceedings: The Sarbanes-Oxley Act 2002. The legislative response to the accounting scandals was straight out of the Stigler (1964, 1971) - Peltzman (1976) playbook. Applying Peltzman's (1976) theory, Watts and Zimmerman (1986, pp. 229-231) argue that the political process has an incentive to avoid perceived responsibility for investor losses and that legislative action is a political attempt to escape blame. Spurred on by the White House and the press, by declining US prestige, by a declining dollar, by declining share prices, by the events of September 11, and by an economic downturn, Congress rushed to pass the Sarbanes-Oxley Act. The House vote was 423-3, and the Senate vote was 99-0. President George W. Bush immediately signed it into law on 30 July 2002.

Market Reaction to the Corporate Gate Keeping Failures: We do not have the opportunity to observe a world in which market or political/regulatory processes operate independently, so it is only possible to conjecture the response of a completely unregulated marketplace would have been. Even if we could observe market forces separately, Hayek (1945, 1988) continually reminds us that they are complex, dispersed, difficult to identify fully, and easy to underestimate. Nevertheless, it is possible to identify some market mechanisms that operated and attempt an assessment of their effectiveness. In parallel to the political and regulatory response to the scandals, the market response had two branches:

penalties assessed against those accused of past negligence or fraud and adaptive changes in institutional arrangements aimed at reducing its future incidence.

Civil Proceedings and Damages Awards for Corporate Gate Keeping Failures: While the criminal prosecution cases attracted most worldwide public attention, a blizzard of private litigation was launched against firms, managers, board members, audit firms, insurance companies, and any parties alleged to have been complicit in financial reporting malpractices. Civil litigation is prosecuted by private litigants who allege the actions of others harmed them. Litigants included stockholders, creditors, bondholders, employees, labour unions and pension plans. Defendants found guilty in securities cases are punished by the courts awarding monetary compensation to the litigants for the damages they have incurred due to the harmful actions. Unlike criminal proceedings, civil litigation is a private, market process of enforcing explicit and implicit contracts between firms, managers, auditors, creditors, shareholders and other contracting parties.

Reputation, Bonding and Insurance Effects of Corporate Gate Keeping Failures: Reputation effects have long been viewed as a robust market mechanism, imposing penalties on parties found to have acted up. Karpoff and Lott (1993) document substantial reputational costs to firms committing fraud generally. In the audit industry, the audit firm's reputation for independent, professional work is central to performing its economic role of verifying financial statements for use by uninformed outsiders. DeAngelo (1981) argues that large audit firms, like Arthur Andersen before its demise, earn substantial quasi-rents, which they stand to lose if they perform poor-quality work. Research has shown that audit firm reputation is associated with audit fee premiums (Simunic, 1980; Francis, 1984; Francis and Simon, 1987; Palmrose, 1986; Craswell, Francis and Taylor, 1995) and with the market valuation of their clients (Kellogg, 1984; Beatty, 1989). Palmrose (1986, 1987) links litigation risk to audit quality. Events that could reduce auditors' reputations, such as regulatory action or private litigation against them, are associated with stock price reductions for clients (Loebbecke *et al.*, 1989; Firth, 1990; Moreland, 1995; Franz *et al.*, 1998), with loss of clients (Firth, 1990; Wilson and Grimlund, 1990), and with reductions in audit fees (Davis and Simon, 1992).

Audit Firm Conflicts of Interest of Corporate Gate Keeping Failures: Part of the adverse public and political reaction to the accounting scandals was the revelation that audit firms conduct substantial non-audit work for their clients, thereby creating at least the appearance of a conflict of interest. Conflicts of

interest were given at least partial blame for the scandals by the press (e.g., Herrick and Barrionuevo, 2002) and by some researchers (e.g., Coffee, 2002). In response to the adverse reaction, Sarbanes-Oxley prohibits the type of non-audit work by the company's auditor that would compromise its independence in performing the audit. Examples include the provision of bookkeeping and internal audit services, where as an external auditor, it would, in effect, be auditing its work. The Act sensibly does not prohibit other services, such as tax advice. There are several reasons to doubt whether this statutory prohibition was advisable or necessary. *First*, the hypothesis that audit firms allow their audit judgment to be compromised by non-audit revenues does not make as much sense as one might initially believe. Why would audit firms attach such a low value to their reputations as independent auditors? Why would they willingly place the entire capital of the partnership at risk by cutting audit quality? The hypothesis might seem to make sense if one accepted the premise that they were earning quasi-rents on non-audit business but none on audits. They then might seem to have little to lose by reducing audit quality to attract lucrative non-audit engagements. However, even if one accepted that premise, the argument still would make no sense. Why would they willingly risk losing quasi-rents on their non-audit work by gaining a reputation for poor audit quality? Would not the existence of quasi-rents earned from non-audit business imply that firms with substantial non-audit revenues put up a more powerful bond to guarantee their audit quality and hence are less likely to compromise it? The motives of audit firms are not as clear-cut as many commentators have portrayed them.

Second, if client firms view their reputations are valuable assets, one would expect them to voluntarily avoid contracting for the audit firm to provide any non-audit services that could compromise audit independence. Kinney, Palmrose and Scholz (2004) test this hypothesis, using the need to subsequently restate previously issued financial statements as indicators of low quality financial reporting and auditing. They do not find a pervasive relation between non-audit.

Third, one should not lose sight of the benefits non-audit work brings to clients. The accounting firms have built substantial businesses in consulting, systems, taxation, and litigation support. They have done so in a competitive market. Their comparative advantage appears to lie in a combination of training, cost and specific client and industry knowledge. Excessive restrictions on using their comparative advantage can impair economic efficiency.

Fourth, there is substantial evidence that non-audit business does not lead to audit firms compromising their audit judgments. If anything, the evidence in these studies points to non-audit revenues being associated with less favourable audit treatment, most likely because financially weaker firms exhibit greater use of

consultants and also receive harsher audit opinions. *Fifth*, before the passage of Sarbanes-Oxley and in response to the scandal-induced *perception* that conflicts of interest influenced audit judgment, all but one of the major accounting firms decided to cease providing internal audit and audit-related technology consulting services to clients where they are the external auditor. This decision was made by Arthur Andersen (still operating at the time), Ernst & Young, KPMG, and Price water house Coopers. Deloitte & Touche alone among the then Big Five audit firms resisted the change, arguing with some justification that the issue was one of perception arising from "the level of hyperbole in the debate. Nevertheless, perceptions do matter, and it is not clear that Deloitte would have been able to hold out on this position for long. In any event, Sarbanes-Oxley codified the standard that the market had moved mainly to in response to the scandals.

Failure of Corporate Gate Keeping Resulted in Bank Scandals Show How Powerless we Are

1. In September 2013, JP Morgan Chase announced they would pay $970 million in fines to US and British regulators and made a rare admission of wrongdoing over action involved in last year's "London Whale" trading scandal. Additionally, the Consumer Financial Protection Bureau announced that JPMorgan Chase and Chase Bank have agreed to pay refunds totalling $309 million to more than 2.1 million customers after the Office of Comptroller or Currency "found that Chase engaged in unfair billing practices for certain credit card 'add-on products' by charging consumers for credit monitoring services that they did not receive."
2. The LIBOR scandal came into focus last year when it was discovered that banks were allegedly falsely inflating or deflating their interest rates to profit from trades or give the impression that they were more creditworthy than they were. The Libor is an average interest rate calculated through submissions of interest rates by the Central Bank in London, which means that banks allegedly were lying A LOT to sound better. The LIBOR underpins about $350 trillion in derivatives, a type of security that gains its value from the value of underlying entities–i.e., interest rates. It is allegedly a massive price-fixing scandal, arguably the biggest ever.
3. 2009, Wells Fargo Bank agreed to pay $175 million to settle accusations that its brokers discriminated against black and Hispanic borrowers during the housing boom.
4. This past summer, 21-year-old Bank of America Intern Moritz Erhardt was found dead in the shower. Erhardt had reportedly worked three consecutive all-nighters. Numerous outlets have indicated this is not

uncommon with banking interns and is part of an unofficial "hazing culture" where interns work around the clock.

5. 2012, UBS lost $2.3 billion after 32-year-old Kweku Adoboli went rogue and made several "vast and risky bets." Britain's financial regulator fined UBS after determining that its "internal controls were inadequate." Adoboli was sentenced to seven years in prison.
6. 2010 was reported that a Kabul Bank took $861 million out of war-ravaged Afghanistan in a massive fraud cantered around fake loans to 19 individuals and companies. A bailout of the bank costs the equivalent of 5 per cent of Afghanistan's GDP, ensuring this is one of the world's most extensive banking failures of all time.
7. August 2012, the Senate reported that HSBC's lax anti-money laundering policies allowed Mexican drug money and Iranian terrorist to enter the U.S. and gain access to U.S. dollar liquidity over the past few years. Forbes reported that "HSBC actively circumvented rules designed to 'block transactions involving terrorists, drug lords, and rogue regimes.'" They were ordered to pay US and British regulators $1.9 billion.
8. December 2012, British bank Standard Chartered paid $327 million in fees to U.S. regulators over alleged illegal transactions with Iran, Sudan, Libya, and Burma. In August 2012, Standard Chartered paid $340 million to a New York state regulator over similar allegations. The NY Department of Financial Services noted that the British bank colluded with the Iranian government for almost an entire decade, reaping hundreds of millions of dollars in fees through thousands of secret transactions, coming to a total of $250 billion.
9. Early/mid-2000's financial services firm Lehman Brothers borrowed significant amounts to fund its investing, a process known as leveraging. A significant portion of this investing was in housing-related assets, making it vulnerable to a downturn in that market. When that happened, Lehman was forced to file for bankruptcy–it remains the largest bankruptcy filing in history, with Lehman holding over $600 billion in assets.
10. March 2010, a report from Anton R. Valukas, the Bankruptcy Examiner, called attention to the use of Repo 105 transactions to boost Lehman Brothers' apparent financial position around the date of the year-end balance sheet. Attorney general Andrew Cuomo later filed charges against the bank's auditors Ernst & Young in December 2010, alleging that the firm "substantially assisted… a massive accounting fraud" by approving

the accounting treatment. A month later, a New York Times story revealed that Lehman had used a small company named Hudson Castle to move several transactions and assets off Lehman's books as a means of manipulating accounting numbers of Lehman's finances and risks.

11. Fall of 2010, major U.S. lenders such as JP Morgan Chase, Ally Financial (GMAC), and Bank of America suspended judicial and non-judicial foreclosures across the United States over the potentially fraudulent practice of robo-signing. It became known as "foreclosuregate," which refers to "the widespread epidemic of improper foreclosures initiated by large banks and other lenders."
12. In June 2009, the SEC charged Angelo Mozilo, the former executive of mortgage lender Countrywide Financial with fraud for allegedly misleading investors about the quality of Countrywide's loans. Among other things, this included tens and billions of dollars of risky subprime and adjustable-rate mortgages. Before Countrywide was sold to Bank of America, it had been the largest NY mortgage lender. In 2010 Mozilo agreed to pay $67.5 million in fines and was hit with a lifetime ban from serving as an officer/director of any public company.
13. In 2009 a grand jury accused Raj Rajaratnam, founder of one of the world's most significant hedge funds called "the Galleon Group", of using a network of company insiders to tip him off to information that netted $20 million in illegal profits over three years. He was found guilty in May 2011 and was sentenced to 11 years in prison.
14. In October 2009, the SEC demanded a jury trial on claims that Bank of America misled shareholders about $3.6 in bonuses paid to Merrill Lynch employees before the companies merged. According to Reuters, "U.S. District Judge Jed Rakoff was disturbed that the SEC did not require the bank to disclose the names of executives and lawyers who vetted the bonuses."
15. In December 2008, it was revealed that the Wall Street Firm Bernard L. Madoff Investment Securities LLC was a massive Ponzi scheme–meaning it paid back investments with money from other investors instead of actual profit. Prosecutors estimated the size of the fraud to be $64.8 billion. Not too shabby.

Section II: Existence of Corporate Gatekeepers

Theoretically, the services of gatekeepers can be performed from within or outside the corporation. Legally, corporations undertaking business transactions must have their accounts audited by an external auditor but are otherwise free to choose

Cost of Scams in the banking sector due to Corporate Gate Keeping in Bangladesh

Banks	Key irregularity	Measures taken
Sonali, Janata, NCC, Dhaka, Mercantile Bank (2008–2011)	BDT 40.89 million (approximately US$ 0.58 million) bank loan with forged land documents (Dhaka Tribune, 28 August 2013)	On 1 August 2013, Anti-Corruption Commission (ACC) filed cases against Sonali Bank, Fahim Attire, and certain individuals; BDT 10 million (US$ 0.13 million) was given back to Sonali Bank (Dhaka Tribune, 2 August 2013; New Age, 2 August 2013; The Daily Star, 2 August 2013)
Basic Bank (2009–2013)	BDT 45,000 million (approximately US$ 604 million) with dubious accounts and companies (The Daily Star, 28 June 2013)	In September 2015, ACC filed 56 cases against 120 people (New Age Bangladesh, 13 August 2018)
Sonali Bank (2010–2012)	BDT 35,470 million (approximately US$ 472 million) embezzled by Hall Mark and other businesses (The Daily Star, 14 August 2012)	In October 2012, ACC filed 11 cases against 27 people (Dhaka Tribune, 11 July, 2018)
Sonali Bank (2010–2012)	BDT 35,470 million (approximately US$ 472 million) embezzled by Hall Mark and other businesses (The Daily Star, 14 August 2012)	In October 2012, ACC filed 11 cases against 27 people (Dhaka Tribune, 11 July, 2018)
Janata Bank (2010–2015)	BDT 100,000 million (approximately US$ 1.3 billion) appropriated by Crescent and AnonTex (Dhaka Tribune, 3 November 2018)	On 30 October 2018 the Enquiry Committee of Bangladesh Bank submitted a report (Dhaka Tribune, 3 November 2018)
Janata Bank, Prime Bank, Jamuna Bank, Shahjalal Islami Bank, Premier Bank (June 2011–July 2012)	BDT 11,750 million (approximately US$ 151 million) by Bismillah group and associates. (The Daily Star, 7 October 2016)	On 3 November 2013, ACC filed 12 cases against 54 people (The Independent, 11 September 2018)
AB Bank (2013–2014)	BDT 1,650 million (approximately US$ 21.2 million) (The Daily Star, 12 June 2018)	On 25 January 2018 ACC filed a case against the former chairman and officials of AB Bank (The Daily Star, 12 March 2018)
NRB Commercial Bank (2013–2016)	BDT 7,010 million (approximately US$ 90 million) of loan (New Age Bangladesh, 10 December 2017)	On 29 December 2016, the Bangladesh Bank appointed an observer to check irregularities (Dhaka Tribune, 7 December 2017)
Janata Bank (2013–2016)	BDT 12,300 million (approximately US$ 158 million) of loan scam (The New Nation, 22 October 2018)	In October 2018, Thermax requested to reschedule the loan, and Janata Bank's board endorsed it and sent it to the Bangladesh Bank (The Daily Star, 21 October 2018)
Farmers Bank (2013–2017)	BDT 5,000 million (approximately US$ 63.7 million) of fund appropriation by 11 companies (The Daily Star, 24 March 2018)	In January 2018, the Bangladesh Bank directed that an audit be conducted. In April 2018, ACC arrested four accused persons (The Independent, 11 April 2018)
Bangladesh Bank (5 February 2016)	BDT 6,796 million (approximately US$ 86.6 million) by international cyber hacking from the treasury account of Bangladesh Bank (The Daily Star, 5 August 2017)	On 19 March 2016, the Government formed a three-member investigation committee (The Daily Star, 5 August 2017)

Mirza Hassan, Syma Haque, Towhid Iqram Mamood, Salim Raihan (2020) Political Economy of Bank Governance in Bangladesh Institutional Diagnostic WP20/BDID[06] Source: Khatun (2018)

whether to rely on the market for gatekeeping services. Typically, they choose to rely on external gatekeepers. Analysis of the question begins with Ronald Coase's seminal insight that a firm will make products or services internally until the costs of doing so exceed the costs of relying on the market (Ronald H. Coase, 1937). In applying this criterion to the market for gate keeping services, the firm will weigh production cost advantages of relying on the market against the transaction cost disadvantages of doing so. Transaction costs are the costs of searching for, contracting with, and monitoring the market providers of the services [(Don E. Waldman & Elizabeth J. Jensen, (1998); Oliver E. Williamson, (1985)].

In the gatekeeping context, corporations must also weigh the information cost advantages of relying on the market. The production cost advantages of relying on the market arise from economies of scale, scope, and experience. Economies of experience— the cost advantages resulting from the accumulated experience over an extended period, also known as "learning by doing"—can be substantial in industries involving complex, labour-intensive activities [(David Besanko & Ronald R. Braeutigam, 2008)]. For example, bankers will develop skills in structuring and negotiating transactions, in applying valuation techniques, and in conceiving business transactions [(Robert G. Eccles & Dwight B. Crane, (1988)]; lawyers will become more adept at negotiating and drafting underwriting and acquisition agreements, responding to regulatory hurdles, and conducting due diligence, a process involving the review of hundreds, even thousands, of documents, many of which adhere to standard forms.

Economies of scale—the decrease in production costs that occurs as production increases—may also be realized by relying on the market for gatekeeping services. With a sizeable transactional flow, gatekeeping firms will build up a greater reservoir of knowledge of transaction structures and standard form agreements [(Michele DeStefano Beardslee et al., Feb. 21, 2010)] and thus be able to provide their services more cheaply than could a corporation with a weaker transactional flow. The need for indivisible units, such as document management systems and physical libraries, the costs of which are invariable to the number of users, would also favour relying on external firms since unit costs would decrease as output (or the number of users) increases. Further cost advantages stem from the ability of external gatekeeping firms to absorb the risk of lumpy demand for professional services more effectively.

A key feature of gatekeepers is their role in economizing on the information costs due to information asymmetry between the two sides of a business transaction. In the context of a securities offering, where this role is most salient, investors face high costs associated with acquiring information to accurately value the assets to be transferred and greet a corporation's disclosures with

caution, aware of its incentives to mislead. Gatekeepers certify that corporation's disclosures by associating themselves with a transaction by acting for the corporate issuer. Gatekeepers thus represent a response—either legal or market, depending on whether the gatekeeper's role is legally mandated—to the problem of information asymmetry [(Ronald J. Gilson, (1984)].

Gatekeeper certifications provide a measure of assurance to investors as to the accuracy of corporate disclosures, reducing the extent to which investors, fearing they will be sold "lemons," discount the value of the asset being sold [(George A. Akerlof, 1970)]. In metaphorical terms, gatekeepers are regarded as renting their reputations to corporations, a function that economizes on information costs (Ronald J. Gilson & Reinier H. Kraakman, (1984) and creates value for the relevant corporations. Gatekeepers thus function as so-called reputational intermediaries.

This reputational function of gatekeepers is one suited to the external gatekeeping firm. As an external firm, it can serve as a repeat advisor to corporations. Expecting to be engaged in future transactions to perform the certification role, an external gatekeeper will have strong reasons to build and preserve a reputation for diligence and honesty. In contrast, corporations will have weaker incentives and opportunities to build and preserve reputations since they usually undertake transactions infrequently [(Ronald J. Gilson & Reinier H. Kraakman, (1984)]. They also have direct financial stakes in transactions, weakening their incentives to certify disclosures accurately [(Margaret M. Blair et al., (2008)]. Thus, the certification function of gatekeepers also favours corporations relying on the market for gatekeeping services. The final piece to the analysis concerns transaction costs, which are the costs to corporations associated with searching for, contracting with, and monitoring providers of gatekeeping services. These costs are weighed against the production cost and information cost advantages of relying on the market for gatekeeping services. Transaction costs arise from both the difficulty of writing complete contracts and the opportunism of outside service providers. Incomplete contracts may fail to constrain opportunistic conduct fully, the consequences of which will be more severe when transactions involve greater asset specificity, are more frequent, and are more uncertain. When transaction costs associated with relying on the market exceed the cost advantages of doing so, a corporation will likely produce the necessary inputs internally. Assessing the transaction costs associated with relying on the market for gatekeeping services presents an empirical challenge. We may infer from the pervasive use of gatekeeping firms in business transactions that the cost advantages of relying on the market exceed the associated costs of transacting. This inference is supported by the observation that, for some business

transactions, standardized practices and contracts have been developed that would reduce transaction costs [(Cox et al., 2005)]. Of course, the picture is more complicated than this: corporations do rely on the market for gatekeeping services, but their internal "deal teams" also provide some gatekeeping services [(Vipal Monga & Suzanne Stevens, 2009)]. Nevertheless, even the most sophisticated corporations continue to turn to external advisors for significant transactions and may even demand a greater breadth of advice from them than they have in the past.

Existence of Multiple Gatekeepers

Having decided to rely on the market for gatekeeping services for a transaction, corporations will turn to multiple distinct gatekeeping firms rather than a single multidisciplinary firm that bundles legal, accounting, financial, and other services. This phenomenon is the immediate result of legal regulation. The relevant professional bodies have "fought zealously to protect their professional autonomy" [(Ronald J. Gilson & Reinier H. Kraakman, (1984)], prohibiting their practitioners from forming multidisciplinary firms and preventing other professions from making incursions onto their turf. (John Flood, 2001). These measures may be explained as the product of demand for favourable regulation by the professions acting as political interest groups [(George J. Stigler, Richard A. Posner (1974)]. The legal profession, in its Model Rules of Professional Conduct, prohibits lawyers from forming partnerships or professionally associating with non-lawyers, including auditors and underwriters [(Model Rules of Professional Conduct (2009)]. Accountants are subject to strict rules preventing them from simultaneously providing auditing services and other services that may be seen to impair the auditor's independence of judgment (AIPCA 2004). An auditor cannot, for example, venture into the investment banking field, such as by underwriting a securities offering for one of its auditing clients. These rules requiring auditor independence were reinforced by provisions of the Sarbanes-Oxley Act of 2002. While the Financial Industry Regulatory Authority, the securities industry's self-regulatory body, does not similarly restrict the activities of investment banks, the rules of the legal and accounting professions, together with the legislative overlay of the Sarbanes-Oxley Act, effectively prevent investment banks from providing auditing and legal services for business transactions [(the United States v. Arthur Young & Co., (1984)].

Whether the legal framework preventing the formation of multidisciplinary gatekeeping firms reflects economic forces or stands in opposition to them is more difficult to assess. One economic explanation for the lack of multidisciplinary firms is the concern among corporations about conflicts of

interest that would afflict the independence of judgment of gatekeepers. While the provision of multiple products and services may provide economies of scale and scope, it also produces conflicts of interest that risk impair a gatekeeper's judgment and thus the certification role the gatekeeper performs. In an extreme case, one could imagine lawyers or auditors in a multidisciplinary gatekeeping firm acquiescing in corporate conduct (which they might otherwise oppose) to facilitate a transaction that would be particularly lucrative to the firm's investment banking unit. This tension between multi-product or multidisciplinary practice and the potentially adverse effects of conflicts of interest has been particularly evident in the accounting profession [(Frederic S. Mishkin, (9th ed. 2010)]. The concern stems from auditors' pressure to skew audit reports where doing so could win their firm other, more lucrative business, such as consulting work. Similar issues arise in the debate concerning the merits of financial conglomeration [(statement of Joseph E. Stiglitz, (2009)]. In the investment banking context, client concerns about conflicts of interest are manifested in corporations increasingly hiring so-called independent investment banks as "a counterpoint to the advice of integrated firms" (Philip Augar, (2005). Client concerns may also explain the failure of multidisciplinary firms, which arose in continental Europe from combinations of accounting and law firms, to break into advising on global securities offerings, a context in which the reputations of advisors are of considerable importance.

Cost advantages, or synergies, and conflicts of interest may well be two sides of one coin, a point suggested by the now-disgraced former securities analyst Jack Grubman, who was quoted as saying (before his ban from the securities industry), "What used to be a conflict [of interest] is now a synergy [(Arianna Huffington, June 6, 2002)]." Conflicts of interest afflicting gatekeepers, and the corresponding lack of independence, can impair a gatekeeper's reputation and the quality of its certification as to the accuracy of a corporation's disclosures. For this reason, doubt exists as to whether, if the existing legal barriers were removed, multidisciplinary firms would evolve and be relied upon by corporations undertaking business transactions.

While this issue need not be pursued for present purposes, it is sufficient to note that particular consequences associated with the multiple gatekeeper phenomenon, which are discussed next, are the immediate product of legal rules and might be alleviated if market forces were given more extraordinary reign.

The Gatekeeping Web

Various consequences flow from the multiple gatekeeper phenomenon. One is that the services performed by gatekeepers intersect, overlap, and complement one

another. The boundaries among the skills that are "legal," "accounting", and "financial" are not delineated. [(James C. Freund, (1975); Milton C. Regan, Jr., (2005)]. The traditional distinctions among professionals have blurred and broken down and are likely to continue to do so. For example, business lawyers must know and use accounting concepts since they "affect the structuring of deals, their disclosure, the form and amount of consideration, and other aspects of negotiations and compliance [(Lawrence A. Cunningham, (2002)]." Today, investment bankers are tested on their knowledge of federal securities laws, corporate law principles, and other legal matters to receive industry certification. Still, each profession has particular areas of expertise and spheres of influence in transactions [(William Powers, Jr. et al., (Feb. 1, 2002)]. The professions can also be expected to vary in terms of the information they hold and their means of gathering information about their client. Accordingly, a gatekeeper may need to rely on the information or advice of another gatekeeper in order to perform its role.

Against this backdrop, it is unsurprising that optimally deterring securities fraud may require more than a single gatekeeper to take precautions. By extension, gatekeepers are more accurately envisioned as an interlocking and interacting web of protection against securities fraud than as a single guardian or even a series of guardians acting in isolation of one another, as portrayed by existing literature. A further consequence of the multiple gatekeeper phenomenon concerns the variability of the contours of the gatekeeping web. Where overlaps among the functions of gatekeepers exist, corporations may have less success with a strategy of shopping for gatekeepers, using them sequentially until finding one that acquiesces in corporate wrongdoing. On the one hand, the presence of multiple gatekeepers increases the likelihood of cross-checks and greatly complicates that strategy, diminishing its appeal.

On the other hand, the existence of multiple gatekeepers may lead each to become a mere functionary, responsible only for a limited portion of the transactional process and with correspondingly diminished knowledge of both the client and the nature of the transaction. This latter scenario relates to the deterioration of gatekeepers' capacity to monitor and control corporate conduct, potentially leading to gaps in gatekeeper oversight that permit corporate wrongdoing. It may even create incentives for gatekeepers to minimize their involvement in transactions, since doing so would allow them plausibly to deny knowledge of client wrongdoing—a relevant consideration when liability under Rule 10b-5, the broadest antifraud provision in the regulatory arsenal, as well as rules of professional responsibility, requires proof of scienter. This concern is borne out by the practice of professionals in providing opinion letters to clients

(as to the accuracy of the corporation's disclosures) of heavily qualifying their assertions and narrowly defining their area of expertise and scope of involvement in the transaction. If securities fraud did occur, the concern would be manifested by multiple gatekeepers pointing an accusatory finger at other gatekeepers.

Another potentially troubling product of the multiple gatekeeper phenomenon is the opportunity it creates for clients to disaggregate their work among multiple gatekeepers to minimize the ability of any individual gatekeeper to deter securities fraud. The adverse effects of such a practice could be exacerbated if the client also interposes between the various gatekeepers, rather than allowing them to interact directly. The 2008 merger of Bank of America and Merrill Lynch illustrates this concern. That transaction dominated financial media headlines and attracted congressional and regulatory scrutiny after revelations that Bank of America knew of massive losses by Merrill Lynch, the company with which it merged, but failed to disclose information about these losses to its shareholders adequately. Bank of America's law firm, which possessed no independent knowledge of the quantum of Merrill Lynch's losses, advised the bank to disclose those losses prior to the shareholder vote, according to allegations of the New York Attorney General. The firm was then allegedly "marginalized" by the bank from decision making concerning the disclosure issue. The bank's accounting firm, another gatekeeper centrally involved in the deal, noted the disclosure problem since the firm was involved in quantifying the losses and recommended that the bank seek the advice of legal counsel. However, by this time, the legal advisor had already been marginalized. The fragmented nature of gatekeeping services and the interposition of the client appear to have weakened the gatekeeping net, diminishing the capacity of the gatekeepers to deter potential securities fraud.

Section III: Differentiating Corporate Gatekeepers

Collective blame for recent business failures has fallen on gatekeepers. The conventional view is that auditors, lawyers, underwriters, analysts, and others have shirked their responsibilities and permitted illegal conduct. If we clarify and enhance the responsibilities of gatekeepers, some say we will avoid such debacles in the future [(Assaf Hamdani, (2003); Hillary A. Sale, (2003); John C. Coffee, Jr., (2004); Frank Partnoy, (2004)]. This claim traditionally depended on a rational actor model under which a gatekeeper would prevent misconduct by a primary violator because the gatekeeper's expected liability or reputational harm from failing to prevent misconduct exceeded the benefits gained in fees [Lawrence A. Cunningham, (2004); Jill E. Fisch & Carolina M. Gentile, (2003); Sean Griffith, (2003); Reinier Kraakman, (Peter Newman ed., 1998)]. Because investors

Brief History of Corporate Governance: (1600-2010)

1600s: The East India Company introduces a Court of Directors, separating ownership and control (the U.K., the Netherlands)
1776: Adam Smith, in the "Wealth of Nations", warns of weak controls over and incentives for management (U.K.)
1844: First Joint Stock Company Act (U.K.)

1931: Berle and Means publish its seminal work "The Modern Corporation and Private Property" (U.S.)
1933/34: The Securities Act of 1933 is the first act to regulate the securities markets, notably registration disclosure. The 1934 Act delegates responsibility for enforcement.
1968: The EU adopts its first company law directive (EU)
1987: The Treadway Commission reports on fraudulent financial reporting, confirming the role and status of audit committees and develops a framework for internal control, or COSO, published in 1992 (U.S.)
1987: The National Assembly of Vietnam adopts the Foreign Investment Law
1990: The National Assembly of Vietnam adopts the Company Law13 and the Law on Private Enterprises14
Early 1990s: Polly Peck (£1.3 billion in losses), BCCI and Maxwell (£480 million) business empires collapse, calling for improved corporate governance practices to protect investors (U.K.)
1992: The Cadbury Committee publishes the first code on corporate governance, and in 1993, companies listed on the U.K.'s stock exchanges are required to disclose governance on a "comply or explain" basis
1994: Publication of the King Report (S. Africa)

1994,1995: Rutteman (on Internal Controls and Financial Reporting), Greenbury (on Executive Remuneration), and Hampel (on Corporate Governance) reports are published (U.K.)

1995: Publication of the Vienot Report (France)

1995: The National Assembly of Vietnam adopts the Law on SOEs.
1996: Publication of the Peters Report (the Netherlands)

1999: The National Assembly of Vietnam adopts the Law on Enterprises, which replaces the Company Law and the Law on Private Enterprises
2000: The National Assembly of Vietnam amends the Foreign Investment Law of 1996

2000: The National Assembly of Vietnam adopts the Law on Insurance Business
2001: Enron Corporation, then the seventh-largest listed company in the U.S., declares bankruptcy (U.S.)
2001: The Lamfalussy Report on the Regulation of European Securities Markets (EU) is published

2002: The Government Office of Vietnam issues the first Model Charter of listed companies16
2002: The Enron collapse and other corporate scandals led to the Sarbanes- Oxley Act (U.S.); the Winter Report on company law reform in Europe is published (EU)

2003: The Higgs Report on non-executive directors is published (U.K.)
2003: The National Assembly of Vietnam adopts the new Law on SOEs to replace the Law on SOEs of 1995
2004: The Parmalat scandal shakes Italy, with possible EU-wide repercussions (EU)

2004: The National Assembly of Vietnam adopts the Law on Competition

2004: The National Assembly of Vietnam amends the Law on State Bank of 1997and the Law on Credit Institutions of 1997
2005: The National Assembly of Vietnam adopts the new Law on Enterprises and the Law on Investment, which replaces (i) the Foreign Investment Law, (ii) the Law on Enterprises of 1999, and (iii) the Law on SOEs
2006: The National Assembly of Vietnam adopts the Law on Securities
2007: The MOF of Vietnam adopts the CG Regulations and the Model Charter.
2010: The MOF of Vietnam adopts Circular 09/2010/TT-BTC governing the disclosure of information on the securities market.

1996: The National Assembly of Vietnam adopts the new Foreign Investment Law, which replaces the Foreign Investment Law of 1987	**2010:** The National Assembly of Vietnam adopts the new Law on State Bank and new Law on Credit Institutions
1997: The National Assembly of Vietnam adopts the Law on State Bank and the Law on Credit Institutions	
1998: Publication of the Combined Code (U.K.)	
1999: OECD publishes the first international benchmark, the OECD Principles of Corporate Governance	
1999: Publication of the Turnbull guidance on internal controls (U.K.)	

Adopted: Corporate Governance Manual (2010) In partnership with (Second edition) International Finance Corporation and STATE SECURITIES COMMISSION OF VIETNAM

understand a gatekeeper would not act irrationally, his statements are believed [John C. Coffee, Jr. (2005)]. While this model has merits, it fails to distinguish among gatekeepers, likely to respond differently to incentives. It also fails to appreciate differences in the character of a gatekeeper's relationship with a primary violator and to consider whether such differences bear upon gatekeeper behaviour [John C. Coffee, Jr., (2004)].

This section examines gatekeepers by focusing not on their similarities but their differences. All gatekeepers are not alike. They vary widely in their functions, skills necessary for the job, relationships with their principals, and duties they owe. There are differences in their approaches as well. Accounting determinations, for example, are often formalistic and unambiguous, while legal advice is said to be more nuanced, requiring an attorney to explore a range of options with a client, who evaluates the lawyer's advice and then makes up her mind [Steven L. Schwarcz 2005)]. The securities analyst, unlike the accountant or lawyer, makes predictions, which are frequently wrong. Distinguishing among the character of gatekeepers' evaluations is helpful, but it masks more significant differences in the structure of gatekeepers' relationships with their clients.

This article focuses on one difference in the particular that bears closely on whether the gatekeeper can be effective: whether, as a normative matter, the gatekeeper is meant to be independent of the client, acting as a neutral umpire [John C. Coffee, Jr., (2003)] or whether the gatekeeper is meant to be dependent on the client, charged with promoting the client's ends in a fiduciary or similar capacity. The label *dependent* is used because certain gatekeepers depend on the client to determine their agency's nature, purpose, and scope. Distinguishing between independent and dependent gatekeepers, however, is only a starting point. One also must ask why gatekeepers have not been more robust monitors. At least part of the answer is that the conventional view of the gatekeeper's role

is inadequate, focusing on the actions of a single individual rather than the dynamics of the group. Similarly, until recently, Congress, regulators, and courts have relied mainly on a command and control philosophy of governance, rather than addressing biases that can cause one slight misstep but lead incrementally to large scale disasters. Thus, rather than looking at the gatekeeper problem from the perspective of a rational actor, this paper explores it from a behavioural viewpoint.

Advances in behavioural and social psychology demonstrate that others strongly influence individual behaviour [S.T. Fiske, Neil J. Smelser & Paul B. Baltes eds., 2001)]. Commenters in this area have begun to pay attention to the institutional and interpersonal context in which gatekeepers formulate judgments about whether the conduct of others is appropriate [11th Annual Business Law Forum (2006); Symposium, *Corporate Misbehaviors* (2005); Sung Hui Kim, (2005; Marleen A. O'Connor, (2002); Robert A. Prentice, (2000); Donald C. Langevoort, (1993); James D. Cox & Harry L. Munsinger (1985); Revision of the Commission's Auditor Independence Requirements (Dec. 5, 2000)]. Joining this chorus, this article maintains that dependent gatekeepers, far more than independent ones, perform their responsibilities under the yoke of unconscious bias that affects the rigour they bring to the gatekeeping task and the accuracy of their judgments.

Thus, the thesis advanced is that independent agents are better gatekeepers than dependent ones. However, drawing on this literature does not suggest that people who make poor decisions or fail to guard against wrongdoing are not responsible. However, it is easier to investigate harm after it occurs and assign blame than to conduct a searching inquiry into one's underlying decision process to improve it [Elliot Aronson, (8th ed. 1999)]. Furthermore, this paper does not attempt to provide a complete behavioural explanation of gatekeeper conduct but instead raises, for future consideration, whether insights from behavioural psychology can be married with the understanding of the structure of gatekeeper relationships.

Independent and Dependent Gatekeepers

Differentiating Independent from Dependent Gatekeepers: The emphasis on gatekeepers in the financial markets is not new. The early securities laws recognized the difference between independent and dependent gatekeepers in the context of directors. The Securities Act of 1933 placed responsibilities on gatekeepers such as auditors, underwriters, and company directors, and the legislative history to the Securities Act highlighted their role [James M. Landis

(1933)]. In the 1970s, Securities and Exchange Commission actions against gatekeepers such as lawyers and accountants were based on the so-called access or passkey theory of liability. Certain professionals like lawyers and accountants [Roberta S. Karmel (1982)]. Today such actions often fall under the rubric of "aiding and abetting" or "secondary liability," and the SEC has broad authority to impose sanctions against those who aid and abet violations of the law [Harold S. Bloomenthal & Samuel Wolff, (2d ed. 2006)]. This section distinguishes independent from dependent gatekeepers by examining the roles of four types of gatekeepers: auditors, analysts, lawyers, and underwriters.

Independent Gatekeepers: Gatekeepers are retained as agents to perform a task or a series of tasks for a principal. In the course of doing so, they receive information, as the access theory suggests, that puts them in a unique position to evaluate whether the principal has violated, or is about to violate, the law. However, the tasks they perform and the relationships with their principals vary. Some gatekeepers are supposed to be independent of their clients to critically evaluate a set of facts and render an unbiased opinion for an unknown audience. The normative qualities of independent gatekeepers are illustrated through a closer look at auditors and analysts.

a. Auditors

The auditor of a public company should be the archetypal independent gatekeeper. Federal law requires that financial information filed by public companies be audited by an independent public accountant. In the world of auditing, independence has a special meaning beyond exercising the independent judgment required of most professionals. Independence calls for the independence of the *audit client*. The Supreme Court contrasted the roles of the auditor and the lawyer concerning independence. In deciding whether the work-product privilege applies to auditors, the Court explained:

> *The Hickman work-product doctrine was founded upon the private attorney's role as the client's confidential advisor and advocate, a loyal representative whose duty is to present the client's case in the most favourable possible light. An independent certified public accountant performs a different role. By certifying the public reports that collectively depict a corporation's financial status, the independent auditor assumes a public responsibility transcending any employment relationship with the client [the United States v. Arthur Young & Co (1984)].*

An auditor cannot be the client's advocate. In the Arthur Young case, the Court concluded by saying that the "'public watchdog' function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust." Indeed, the courts have stated that accountants have disclosure obligations because of their "special relationship of trust vis à-vis the public" and their duty to "safeguard the public interest [Rudolph v. Arthur Andersen Co., (11th Cir. 1986)]." An accountant who knows of or recklessly disregards fraud can be liable for aiding and abetting it. The law discourages auditors and clients from developing long-term relationships. An auditor's long-term relationship with a client can jeopardize independence, something accounting literature refers to as a *trusted threat [AICPA, Guidance for Independence Discussions with Audit Committees*, May 1999 (Updated through November 1, 2000)]. Under SEC rules required by Sarbanes-Oxley, audit partners must "rotate off" an audit engagement after no more than seven years—presumably to cut short the relationship between auditor and client before it can blossom into a trust relationship that can impair independence [Securities Act Release No. 8183 (Feb. 5, 2003)].

The contrast between auditors and lawyers also is seen by comparing rules of imputation used by accounting firms, as opposed to law firms. Unlike accounting firms, law firms have strict imputation rules that arise from the lawyer's duty of loyalty [Model R. of Professional Conduct (2003)]. If one lawyer in a firm has a conflict of interest for a client, the conflict is imputed to the firm. With hundreds of clients and lawyers switching firms often, conflicts quickly arise [Casita, LP v. Maplewood Equity Partners (N.Y. Sup. Ct. Feb. 22, 2006)]. Large law firms manage conflicts daily by imposing procedures to ensure that information gained by an attorney regarding one client does not fall into the hands of another attorney at the firm, who might be under a duty to use the information for the benefit of another client. Accounting firms are not so constrained. A conflict by one member of an accounting firm will only preclude the firm from accepting an engagement if the conflict could be viewed as impairing another member's objectivity [Aicpa Code of Professional Conduct (1995)]. Similarly, AICPA rules impose duties of confidentiality, but they do not impute the knowledge of one member of the firm to everybody else. Accounting firms routinely audit the books of competitors or companies that have business relationships with one another.

b. Securities Analysts

The second example of an independent gatekeeper is the securities analyst. An analyst is supposed to research a company to judge its value as an investment [Jill E. Fisch & Hillary A. Sale (2003]. The analyst's role should review corporate

information and present an unvarnished view of the company to investors or potential investors. The analyst's role should not be to advocate on behalf of the company but rather, as the auditor, objectively analyse the facts. Conflicts of interest must be disclosed [Securities Act (Supp. II 2002)]. The Supreme Court noted that the analyst's role in many cases is to expose adverse facts the company may wish to withhold [Dirks v. SEC (1983)]. Like with auditors, long-term relationships between analysts and issuers are discouraged. Evidence indicates that the longer an analyst follows a company, the more likely he is to evaluate the company positively [Paul M. Healy & Krishna G. Palepu (July 2003)]. Longevity leads to error. The view of the analyst as independent is under attack. Over the past several years, the principal criticism waged against analysts is that they have slowly lost their independence and become adjuncts of the investment banking departments of the firms that employ them [Nocera, N.Y. TIMES, Mar. 4, 2006]. These criticisms are valid and reinforce the view that the norm for the analyst is independence. If independence were not expected, analysts would not be denounced for losing their objectivity.

Dependent Gatekeepers

While some gatekeepers like auditors and analysts are supposed to be independent of their principal, others are not. Dependent gatekeepers provide advice and recommendations to assist a client in meeting its goals. They often act in a fiduciary capacity, owing to both a duty of loyalty and care to the client. As a fiduciary, these agents must act for the client's benefit, furthering its ends [Restatement (Second) of Trusts (1959)]. Courts maintain that the essence of the fiduciary duty is to act with "utmost good faith for the benefit" of the principal [Barbara A. v. John G., 145 Cal. App. 3d 369, 372 (1983)] and "single-mindedly pursue the interests of those to whom a duty of loyalty is owed [Birnbaum v. Birnbaum, 73 N.Y.2d 461 (1989)]." Regardless of the context, fiduciary cases are replete with language about how the fiduciary must act to further the principal's objectives [Willers v. Wettestad, 510 N.W.2d 676, 680 (S.D. 1994)].

A fiduciary relationship is characterized by values such as longevity and mutual trust, and fiduciary cases refer to a close bond that exists between the fiduciary and the principal [Broomfield v. Kosow, 212 N.E.2d 556, 561 (Mass. 1965); Strode v. Spoden, (Ky. Ct. App. 1955)]. However, those same bonds are anathema to relationships held by independent gatekeepers, such as auditors and analysts. Moreover, an auditor is not considered a fiduciary to the client when performing the audit function [VTech Holdings, Ltd. v. PricewaterhouseCoopers, (S.D.N.Y. 2004)]. The differences in the type of relationships independent and dependent gatekeepers have with their clients are striking. The characteristics of

dependent gatekeepers are illuminated by examining more closely the role of attorneys and underwriters.

An Attorneys

A prime example of a dependent gatekeeper is the lawyer. Lawyers have a special place in the adversary system, recognising that conflict is inevitable and cannot always be resolved through consensus [Martin H. Redish (2001)]. In the adversary system, lawyers are not meant to be impartial. An attorney is required to "advance the client's lawful objectives and interests." Every lawyer knows about the duty of zealous advocacy. As Geoffrey Hazard has written, "A lawyer's service consists of guiding affairs for the client's private and often selfish purposes, with an eye to legal requirements that have been designed for the very purpose of limiting or regulating selfish purposes."

The relationship between client and lawyer is akin to an "informal partnership." They work together toward a common goal, although the client, not the lawyer, ultimately calls the shots. It is particularly true of in-house lawyers because of their long-term role as employees or subordinates of the client. In describing the lawyer's role, it is helpful to contrast it with the role of the judge. The traditional figure of justice—blindfolded— represents the court or the judge, not the lawyer. The lawyer, particularly in litigation, seeks to achieve success for his or her client to the disadvantage of the opposing client; the judge interposes herself between the two positions, seeking justice. The judge's ethical norm is impartiality; the lawyer is loyal.

Notwithstanding the role of a zealous advocate, the attorney's duty of loyalty is not unlimited. Courts and commentators have recognized the tension between the lawyer's fidelity to his client on the one hand and his role as a gatekeeper on the other—and lawyers are at the centre of the corporate governance debate[Jill E. Fisch & Kenneth M. Rosen, (2003); Dan Ackman, FORBES, (Nov. 30, 2001), Beck, (2003); Jenny B. Davis, (April 2002)]. ABA rules provide that a lawyer cannot "counsel a client to engage, or assist a client, in conduct the lawyer knows criminal or fraudulent." ABA rules permit an attorney to withdraw from representation where the client "insists upon taking action that the lawyer considers repugnant." Recent changes to the ABA Model Rules, which expand the circumstances when a lawyer may breach client confidentiality, illustrate the complexity of the lawyer's role *[The ABA Task Force on Corporate Responsibility (2003)]*. Certain states, such as New Jersey, go farther than the Model Rules and require lawyers to disclose information to prevent a client "from committing a criminal, illegal or fraudulent act that the lawyer reasonably believes is likely to

result in death or substantial bodily harm or substantial injury to the financial interest or property of another."

Studies suggest that attorneys do not take this language entirely seriously. Particularly about financial injury, only a tiny percentage of lawyers make the required disclosure [Leslie C. Levin, (1994)]. It is not surprising as the overall role of the lawyer is to promote the aims and objectives of his client. The unwillingness to make such disclosures is consistent with the insights from behavioural psychology explored below. As one writer noted, "In the law, bias is a professional obligation [Paul G. Haskell (1998)]." While lawyers are occasionally found liable for wrongdoing, the facts of those cases are generally egregious.

While this paper places lawyers in the dependent gatekeeper class, occasionally, one hears that lawyers must be independent. What does independence mean in this context? Geoffrey Hazard has distilled a lawyer's independence to four principles: independence from the state, independence from improper relationships (including other clients and colleagues), independence from personal views regarding politics or morality, and independence from the *client*. This last principle warrants a closer look because if lawyers are supposed to be independent of their clients, they will fall into the category of other independent gatekeepers, like auditors.

However, a lawyer's independence from the client is different from the auditor's or analyst's independence. Hazard explains that a lawyer's independence from the client means forbearing from assisting a client in violating the law or rendering advice that encourages a violation. Such conduct ultimately would harm the client and be tantamount to a violation of the duty of loyalty. Therefore, independence in this particular sense is better described as a *corollary* of the duty of loyalty, not opposed to it. A lawyer is also said to be morally independent from his client because while the lawyer acts on behalf of the client, the actions and responsibilities of the two are distinct [Richard W. Painter (1994)]. Moral independence in that regard does not detract from the thesis of this paper; it supports it because it demonstrates that lawyers, as zealous advocates, make arguments that they may feel uncomfortable making on their behalf.

The lawyer's role as gatekeeper is most evident when giving legal opinions; one should look to determine whether a lawyer is independent of his client. A legal opinion is an informed judgment, usually reduced to writing, on discrete legal issues [Special Committee on Legal Opinions in Commercial Transactions et al., (1979)]. An opinion generally provides the recipient with the lawyer's judgment on how a particular court would resolve a discrete issue *[Third-Party "Closing" Opinions: A Report of the TriBar Opinion Committee, (1998)].*

Lawyers provide opinions to clients and non-clients on several matters that allow a transaction to go forward [Charles J. Johnson, Jr. & Joseph McLaughlin, (3d ed. 2004); Jeanne M. Campanelli & Bradley J. Gans, (2001)]. In giving an opinion, the lawyer does not function as a conventional advocate. Instead, the goal of the opinion giver should be to fairly and accurately provide a legal conclusion based on the relevant facts [Steven L. Schwarcz (2005)]. When a lawyer gives an opinion, and he knows or has reason to know that a third person is likely to rely on it, the lawyer owes a duty of reasonable care [Jay M. Feinman (2000)].

The lawyer's responsibility to a third person when preparing an opinion is in tension with his responsibility to his client. The lawyer as opinion giver is not entirely objective for several reasons. First, a lawyer rendering an opinion often serves a dual role as opinion-giver and engineer of the opening transaction. In that sense, the lawyer is passing on his work, which, as discussed, is prohibited for the independent auditor. Second, opinions typically are negotiated documents whose terms are agreed in advance of the consummation of a transaction. Third, unlike an audit, a legal opinion is considered one aspect of counselling a client who has requested that the lawyer provide the opinion to a third party. As Steven Schwarcz notes, lawyers should have the right to issue opinions to facilitate lawful transactions. They should not be expected to assess the overall legality of the transaction. Finally, an opinion does not give rise to a lawyer-client relationship with the third-party recipient. Even those who advocate a more powerful gatekeeping role for lawyers rendering legal opinions concede that opinion givers are not independent in the same sense as auditors.

b. Securities Underwriters

An investment bank acting as an underwriter in a public securities offering plays a crucial gatekeeping role, but, as we shall see, the underwriter is a dependent gatekeeper in many respects. It may be surprising because the underwriter is said to play a unique role as the only participant who, as to matters not certified by the auditor, has the background and knowledge to conduct a sufficient investigation to protect the investor. Section 11 of the Securities Act names the underwriter, unlike the lawyer, as a potential defendant in a private lawsuit if a registration statement is misleading. Section 11 also provides a due diligence defence to the underwriter, who must undertake a "reasonable investigation" to assure that statements made in the registration statement are factual. The underwriter must perform this responsibility on its own. It cannot rely on information provided by the issuer. "Tacit reliance on management assertions is unacceptable; the underwriters must play devil's advocate." Thus, there is a sense in which the underwriters are acting independently of the issuer to perform the due diligence

required by the Securities Act. The role of the underwriter, however, is more complex.

Notwithstanding the emphasis on due diligence, the underwriter is not meant to be wholly independent of the issuer in the same way the auditor is independent. The issuer engages the underwriter to promote the distribution of its securities [James D. Cox, Robert W. Hillman & Donald C. Langevoort, (5th ed. 2006)]. In that regard, the underwriter's role, as an adviser to the issuer, usually predates the offering itself. In many cases, the managing underwriter provides advice on many issues pertinent to the offering, such as the type and amount of securities sold, the timing of the offer, and steps the issuer can take to make itself more attractive. As a result of advice given, some courts have begun to recognize a fiduciary relationship between an underwriter and an issuer [EBC I, Inc. v. Goldman, Sachs & Co., (N.Y. 2005)]. In addition, an underwriter often has a direct or indirect financial interest in an offering. Some underwriters invest directly in their clients, [Royce de Barondes (2005)] prohibited for independent accountants. Also, many underwritings are performed on a so-called best efforts basis where the underwriter will not receive a fee unless some or all of the securities are sold. In a recent Second Circuit case, the court summarized the underwriter's incentives as follows:

Underwriters have strong incentives to manipulate the IPO [initial public offering] process to facilitate an issue's complete distribution and sale. Underwriting is a business; competitive forces dictate that underwriters associated with successful IPOs will attract future issuers. Moreover, because underwriters assume a considerable measure of risk if an IPO fails, they have a direct interest in the IPO's success. Moreover, underwriters perform multiple services for their clients. Performance of such services, notwithstanding the due diligence responsibility under section 11, distinguishes underwriters from auditors and makes them dependent in a way that auditors now cannot be. Unlike auditors, which are restricted in the performance of non-audit services, underwriters continue to be interested in cultivating the client relationship to obtain additional consulting and other work. The very provision of advice can turn a non-fiduciary relationship into a fiduciary one by dint of reliance by the principal on the skills and expertise of the agent and the trust and confidence reposed in him.

Application of National Association of Securities Dealers (NASD) rules demonstrates that an underwriter is a dependent gatekeeper. In some cases, NASD rules require its members to hire an independent agent (known as a qualified independent underwriter) to conduct due diligence on a registration statement and provide an independent pricing opinion [William M. Prifti, Securities Pub. & Priv. Offerings (June 2006); Harold S. Bloomenthal, Securities Law Handbook

(2006)]. If a conventional underwriter were independent, the NASD rules would be superfluous *[Amendments to the Corporate Financing Rule*, NASD Notice to Members 04-13, Feb. 2004].

This Part demonstrates that all gatekeepers are not alike. Some, like auditors, are meant to be independent of their clients. Others, like attorneys, are dependent on the goals and objectives of their clients and often serve in a fiduciary capacity. Part II explores social and behavioural psychology aspects to determine whether these differences bear on how gatekeepers are likely to behave. Drawing on these insights, Part III discusses how dependent gatekeepers, charged with furthering the interests of their clients, are less likely to be effective gatekeepers than independent ones and what we should do about it.

Section IV: Regulatory regime of gatekeeper liabilities

A. Directors

In the *United States*, the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) imposes increased responsibilities on directors, without direct legal penalties for directors who breach those responsibilities [Public Company Accounting Reform and Investor Protection Act (Sarbanes-Oxley) 18 U.S.C. §7261 (2002)]. In the *United Kingdom*, there have been recent amendments to company law that have relaxed the provisions protecting directors and other company officers from liability [Companies (Audit, Investigations, and Community Enterprise) Act, 2004, Ch. 27, § 19-20 (U.K)]. Amongst these changes are the introduction of director liability to third parties, under sections 19 and 20 of the Companies (Audit, Investigations and Community Enterprise) Act 2004 (C(AICE)). The current Canadian gatekeeper liability regime for directors is in line with the U.S. model but has not gone the U.K. route of attaching additional liability to the additional responsibilities now placed upon directors, particularly independent directors, as gatekeepers.

The *academic literature* suggests that the exact nature of the gatekeeping role that directors should play remains unclear. For example, James Kirkbride and Steve Letza suggest that non-executive directors might serve as internal monitors of CEO behaviour because they have access to privileged information about firm operations, which is inaccessible to public enforcement officials [James Kirkbride & Steve Letza, (2005)]. However, they outline some of the problems associated with imposing gatekeeper liability, including the cost element; if gatekeepers cannot shift their liability risks, they will charge higher premiums. It suggests that imposing increased liability on directors as gatekeepers do not necessarily contribute to a more effective gatekeeper liability regime.

Indeed, *public opinion* does not support an increase in sources of director liability [Ditchley Foundation Conference, Confidence, Control and Compensation: Questions for the Modern Corporation (Sept. 5-7, 2003)]. Instead, increasing transparency and disclosure about directors' salaries may help allay general concerns. The sharp rise in directors' salaries relative to the salaries of the average employee was cited as a significant problem by many Ditchley Foundation conference participants, including business people, regulators, and politicians. Further demonstrating the problem with directors' salaries, the Ontario Teachers' Pension Plan released a report in June 2006 showing little correlation between CEO pay and total stock return [Institutional Shareholder Services, Spotlight on Executive Pay and Board Accountability 38 (2006)]. To combat the *public perception problems* with directors' compensation, the Canadian Coalition for Good Governance has suggested transparency guidelines and assists in their implementation *[Good Governance Guidelines for Principled Executive Compensation,* (Canadian Coalition for Good Governance, Working Paper, 2006)].

Additionally, the recent introduction of the *secondary market civil liability scheme in Ontario* presents an opportunity to evaluate the impact of increased gatekeeper liability for directors and, at the same time, examine the judiciary's role in applying such a regime. Further amendments are not recommended until this experience has been thoroughly evaluated in the Canadian context. Following an evaluation of the current regime, *further consideration should be given to attaching increased liability to the added responsibilities placed on directors, particularly independent directors.*

B. Lawyers

In Canada, the *United States, and the United Kingdom*, lawyers are regulated by law societies and securities statutes. Under section 307 of Sarbanes-Oxley, the SEC has developed rules of professional conduct for lawyers, and those who violate the rules are subject to all remedies and sanctions available to the SEC for the violation of federal securities laws [Sarbanes-Oxley, 18 U.S.C. § 307 (2005)]. *Lawyers are also regulated by their state bar association,* many of which have adopted the American Bar Association's Model Rules of Professional Conduct (Model Rules), though it is up to each bar association to develop its own rules and standards. *In the U.K.*, the Law Society sets out The Guide to the Professional Conduct of Solicitors [The Guide to the Professional Conduct of Solicitors, (Nicola Taylor ed., 8th ed. 1999)]. *Lawyers in the U.K. are also regulated* under the Financial Services and Markets Act 2000 [(FSMA 2000].

Unlike the *U.S. model and more akin to the U.K. model, the Canadian model for gatekeeper liability* for lawyers assigns the essential regulatory function to the provincial law societies. The benefit of this model is that the problem of *conflicting standards in the U.S. between the Rules of Professional Conduct*, set by each state Bar Association and the SEC rules does not arise. It is also the case that the law societies are keenly aware of the competing tensions between lawyers' gatekeeping function and the confidentiality requirements that are required generally of all lawyers. However, there is *variation among the law societies* to the extent that they have created specific rules to address lawyers' gatekeeping functions.

Ontario appears to have created the model most similar to the U.S. model, *striking a balance between lawyers' roles as gatekeepers and advocates.* To improve the competitiveness of Canadian capital markets, it is recommended that each law society consider adopting a similar set of rules—with the input of each provincial securities commission. A more uniform and comprehensive set of rules of professional conduct will simplify the existing system and at the same time ease investors' concerns about the role that lawyers are playing in Canadian capital markets. Following a provincial consultation process, it may be helpful to form a national working group to develop a uniform set of rules of professional conduct.

C. Auditors

After the financial collapse of Enron, there was very little public confidence in auditors and accountants. While it was an American corporation, seventy-three per cent of Canadians doubted their public protections and believed an Enron-like scandal would take place there as well [Pollara, (May 2002)]. Further, inconsistencies between the Canadian and American systems have been highlighted by Al Rosen, founder of the forensic accounting firm Rosen & Associates Ltd. He contends that in 2003, two-thirds of Canadian companies would have lower reported profits if American accounting rules were used in place of their Canadian counterparts. Recent Canadian reforms, detailed below, have helped address these concerns, and this article offers additional suggestions to increase public confidence in auditors further. In the U.S., Sarbanes-Oxley imposed extensive federal regulation on the accounting profession. The act created the Public Company Accounting Oversight Board (PCAOB) to oversee the audit of public companies. *Accounting firms must register* with the PCAOB, which has broad powers to promulgate binding rules and standards, conduct investigations, and impose discipline; by shifting control of the accounting profession to a new body, the PCAOB aims to address the problem of accounting

irregularities by establishing auditing standards and imposing professional discipline.

The U.K.'s counterpart to the PCOAB is the *Financial Reporting Council* (FRC), an independent regulator for corporate reporting and governance, created in April 2004 under the authority of the C(AICE) Act. The functions of the FRC include: establishing, monitoring, and enforcing accounting and auditing standards; regulating auditors; operating an independent investigation and disciplinary scheme for public interest cases; overseeing the regulatory activities of professional accountancy bodies; and promoting high standards of corporate governance [Financial Reporting Council, *Regulatory Strategy* 2 (2006)]. Drawing on the U.S. and the U.K. *models*, the author believes that consideration should be given to conferring SRO status on the Canadian CPAB, subject to oversight by each of the securities regulators; the development of the CPAB provides an opportunity to improve the current gatekeeper liability regime for auditors. The current model, in which the CPAB relies on the ethical standards imposed by the industry bodies that have jurisdiction over auditors, is consistent with the current Canadian self-regulatory approach. However, the status of the CPAB, as a creature of contract, is distinct from other similar organizations, creating issues concerning legitimacy, fairness and effectiveness. Currently, three SROs are recognized by the OSC and most other provincial securities regulators. The SROs currently recognized by the OSC are the Investment Dealers Association of Canada (IDA), the Mutual Fund Dealers Association of Canada (MFDA), and Market

Regulation Services Inc. (RS). It is recommended that the CPAB be accorded SRO status. An SRO is an entity that represents registrants and is organized to regulate the operations, standards of practice, and business conduct of its members and their representatives, to promote the protection of investors and the public interest. In its capacity as an SRO, the CPAB will be better positioned to work with the industry bodies that regulate the accounting profession, thereby ensuring that the ideal level and form of gatekeeper liability for auditors are in place. It would improve investor confidence in the CPAB, as regulator, and auditors, as gatekeepers, because their chief regulator—the provincial securities commission—will be perceived as more legitimate and fair. At the same time, this change will bring the Canadian position more in line with the U.S. and U.K. positions.

The recent reforms and the changes proposed still leave the "two master problem" unresolved: auditors are still asked to treat the public as master but continue to be paid by the corporation [Amy Shapiro (2005)]. While this is

recognized as an issue for gatekeepers, there is insufficient evidence to suggest that the current Canadian system needs to be overhauled entirely at this time. Much has happened in Canada, the U.S., and the U.K. in the context of oversight of auditors over the last five years, and at this point, it is justifiable to resist making further changes and allow the current system to develop while continuing to monitor it. In particular, the recent expansion of the number of accountants who may perform public audits should be observed *[Certified General Accountants Association of Canada, Public Accounting Rights for Certified General* Accountants in Canada, May 2005]. The role that increased competition may play will be a *factor in future regulatory decisions.*

D. Credit Rating Agencies

Commentators such as Frank Partnoy see CRAs as possessing little informational value. While initial credit ratings guide purchases, it is unclear whether they provide any information beyond that already reflected in the "price talk" before a fixed instrument is issued. In the current American context, Partnoy argues that CRAs are important not because they offer valuable information, but because they grant issuers "regulatory licenses"—that is, a good rating entitles the issuer to certain advantages related to regulation. Building on this critique, the best reforms should create incentives for CRAs to generate more excellent informational value while reducing the impact of ratings on markets.

The effectiveness of CRA's *gatekeeping role remains an open question.* However, public perception and academic writing suggest that the existing liability regime does not instil confidence in capital markets and that there is room for modernizing Canadian securities legislation to improve the current situation. Accordingly, reforms to the current regime should focus on creating incentives for CRAs to generate informational value while reducing the market impact of ratings from a small group of CRAs. Given the uncertainty around CRAs' role and no Canadian SRO or industry body charged with regulating CRAs, the securities commissions could play a critical role. Securities legislation should be amended to create a mandatory registration requirement for all CRAs, and the provincial securities commissions should have the power to revoke or suspend the registration of a wayward registrant.

The disclosure obligations formulated by the IOSCO should be a condition to registration with the provincial securities commissions. The registration requirement would bring the treatment of CRAs more in line with the spirit of Canadian securities legislation related to oversight of corporate gatekeepers. Registration would also create a threat of liability for rating malfeasance. Given concerns with imposing civil liability on CRAs, *the ideal gatekeeper liability*

scheme should focus on administrative liability [Stephane Rousseau, (Aug. 2005)]. The IOSCO Code, which CRAs have already generally adopted, presents a good model for imposing liability on CRAs.

E. Financial Analysts

Because of their unique intermediary role in capital markets, *conflicts often arise between an analyst's duty to provide independent, objective advice to investor clients and pressures to support investment banking revenues. In the* current context, buy-side pressures on financial analysts are increasing insignificance. For example, there is an incentive for a mutual fund with extensive holdings in stock to persuade an analyst not to put a "sell" recommendation on the stock that might contribute to a decline in its price. Following the SICAS Report, the IDA has taken significant measures to address the gatekeeping role played by analysts. However, given the recent reforms in the U.S. and the U.K. to *bolster confidence in analysts' function as gatekeepers, analysts should require more detailed disclosure by analysts, with accompanying liability for failure to disclose.* U.S. reforms include SEC Regulation AC (Analyst Certification), effective April 2003, which requires that when a broker, dealer, or covered person furnishes research prepared by a research analyst, the research must include a statement by the research analyst that the research truly reflects the analyst's opinion, and disclose whether or not an analyst received compensation in connection with his or her specific recommendations or views [David J. Labhart, (2004); Sec. and Exchange Commission, Regulation Analyst Certification (Apr. 2003)]. Penalties under the Securities Act (or rules or regulations promulgated under the act, such as Regulation AC) may amount to fines of up to $10,000 or imprisonment of up to five years.

Since July 2004, firms that publish impartial research must have implemented a policy on identifying and managing conflicts to ensure analysts' impartiality. The U.K.'s attempt to raise confidence in analysts' function is found in the Financial Services Authority's (FSA) Conduct of Business Sourcebook, section 7.17, which imposes "fair presentation" and disclosure requirements on analysts [Emilios E. Avgouleas (2005)]. The FSA's rules set out minimum standards for conflict management processes and procedures [Fin. Services Authority (Sept. 2005)].

In Canada, IDA Policy No. 11205 should be amended to require: 1) a statement by the analyst that the research truly reflects the analyst's opinion, and 2) a prohibition on the investment banking department supervising or controlling analysts. Currently, Rule 2(b) requires that members disclose their system for ratings. More specific disclosure requirements, including identification of the

analyst responsible for the production, dissemination of the research and a statement by the analyst that the research truly reflects the analyst's opinion, would bolster investors' confidence in the provided information. This reform will address both sell-side and buy-side pressures facing financial analysts. In addition, members should set policies and procedures under IDA Rule 11 to avoid conflicts of interest and put in place controls and maintain records of supervision of analysts and explicitly prohibit supervision and control of analysts by the investment banking department. While such measures may appear to be outdated to the American reader given that similar measures were introduced in the U.S. in 2003 following Eliot Spitzer's investigation of conflicts of interest at Wall Street investment firms, they are not outdated in the Canadian context [(Conduct Rule 2310) Eliot Spitzer, Office of New York State Attorney General, Conflict Probes Resolved at Citigroup and Morgan-Stanley (Apr. 28, 2003)]. These measures will bring the Canadian approach to gatekeeper liability for analysts more in line with the U.S. and the U.K. approaches while maintaining the Canadian self-regulatory model.

F. Retail Investment Advisors

Recent reform efforts regarding the liability of investment advisors in Canada have not focused on their role as corporate gatekeepers. Instead, the focus has been on establishing consumer protection mechanisms to address power imbalances in investment advisors' relationships with customers. The evidence suggests that consumer protection issues are the most pressing concern in the Canadian context. In certain instances, there is an overlap between liability introduced for more general consumer protection purposes and liability for failure to perform a corporate gatekeeping function. However, recent U.S. and U.K. reform efforts demonstrate that similar issues arise concerning the role of analysts and investment advisors as corporate gatekeepers. Accordingly, similar gatekeeper liability regimes (specific to the role of each gatekeeper) are justified and should be put into place. In the U.S., a complete service investment advisor is obligated to recommend only those securities that match the customer's financial needs and goals (the "suitability obligation"), which is imposed on NASD members through the Rules of Fair Practice. Similar consumer protection issues arise in the American context, a breach of the suitability obligation has grown into the most commonly alleged basis of investor recovery against investment advisors.

To a certain extent, the corporate gatekeeping role of investment advisors in Canada has been underestimated. As a national SRO, the IDA is ideally suited to develop and implement a parallel policy to Policy No. 11, which is specific to the

role of investment advisors. In particular, like Policy No. 11, the policy for investment advisors should build on the existing requirements in securities legislation for disclosure of possible conflicts resulting from the firm's relationships to issuers and clients. The new policy should respond to issues created by relationships in the firm in the same way as Policy No. 11 seeks to respond to relationships between analysts and investment bankers.

G. Underwriters

Recent reforms in the U.S. have not focused on imposing or modifying the liability to which underwriters are subject as gatekeepers. For example, Choi writes that underwriters face strong incentives to act as certifiers; if they can provide credible assurances that an issuer's disclosures are truthful, investors will be willing to pay more for the issuer's securities. *The issuer will then pay more for the underwriter's certification service. There is less need for underwriter liability if they are incentivized to become more independent and arguably better gatekeepers by the market for independent certifiers*. This argument applies to the Canadian context, suggesting that underwriters do not need to be subjected to additional liability.

The current regime subject underwriters to civil, administrative and criminal liability for failure to perform their gatekeeping role. However, the focus is on disclosure of conflicts rather than on enlarging the instances and possibility for gatekeeper liability. In this way, the current regime is consistent with the model that Choi advocates. The reforms introduced by National Instrument 33-105210 help promote this model in Canada and are consistent with the recent and proposed reforms in the U.S. and the U.K. to improve the effectiveness of underwriters' role as gatekeepers. There is insufficient evidence suggesting that increasing or modifying the gatekeeper liability regime underwriters are currently subject to will contribute to more competitive Canadian capital markets. At the same time, time constraint issues related to fast track offerings and the implications for the ability of underwriters to conduct adequate due diligence should continue to be monitored.

Summary

The analysis of the academic literature and the comparative context suggest that developing a streamlined approach to amending the gatekeeper liability scheme in Canada, which comes closer to the U.S. and the U.K. models, is not desirable. Overall, the polycentric legal environment for gatekeeper liability in Canada appears to be developing in a manner that gives gatekeepers guidelines on how to perform their functions and adequate reason to do so. It can be demonstrated by

indexes such as the Rotman School of Management's Board Shareholder Confidence Index, which found that governance scores, designed to reflect the degree to which a company implements elements of good governance, have improved every year since 2003 [Michael Wilson, (Dec. 2005)]. In examining the existing Canadian model where the boundaries between law and professional practice are somewhat blurred, and subsystems of liability that apply to various gatekeepers differ both from gatekeeper to gatekeeper and also geographically, it became apparent that participants in the market and other members of the public may not be aware of the extent of the existing corporate gatekeeper liability regime in Canada. Awareness of the liability scheme plays a crucial role in developing confidence in Canadian capital markets. Accordingly, a final recommendation is made regarding the widespread dissemination and availability of papers that seek to map out the existing gatekeeper liability regime in Canada and situate it in the context of recent academic literature and reforms in comparable jurisdictions.

Section V: Gatekeeper Motivation and Bias

Intuition tells us that a dependent gatekeeper will be ineffective. The dependent gatekeeper faces a dilemma. The gatekeeper can act as a weak monitor, enhancing his potential liability but preserving his client relationship and positioning himself for future business. Alternatively, he can act as a robust monitor, shielding himself from potential liability but possibly damaging his client relationship and acting inconsistently with his fiduciary duty. Liability for breach of fiduciary duty could be overcome by fiat. Congress or regulators could draft laws or rules to trump state common law and limit liability for certain violations of the duty of loyalty. Although such terms could be difficult to negotiate and enforce, the same result might be achieved through a contract. The SEC's attorney conduct rules, which require lawyers to report violations of law "up the ladder" in the business organization, was a partial measure in this regard. In adopting the rules, the SEC reaffirmed that they "shall prevail over any conflicting or inconsistent laws of a state or other United States jurisdiction in which an attorney is admitted or practices [Investment Company Act (Feb. 6, 2003)]." While the rules are controversial, the ABA recognized that federal law might provide a basis for the pre-emption of attorney-client confidentiality [Letter from Alfred P. Carlton, Jr., President, American Bar Assoc. to Jonathan G.Katz, Sec'y, SEC (December 18, 2002)]. Even if such protections are available, open-ended responsibilities placed on fiduciaries to act as gatekeepers are unlikely to be effective. One reason for this, Part I demonstrates, is that a dependent gatekeeper should be committed to furthering the goals of his principal. This part explores a related reason, namely

whether a gatekeeper's decision-making process in determining whether to act in a way that could harm his principal is constrained by unconscious bias. This Part begins with a short discussion of how conventional analysis has failed and why incorporating behavioural and social psychology lessons is essential.

a. Failures of Conventional Analysis

The primary failure of the traditional analysis of gatekeeper liability is that it did not sufficiently consider the dynamics of the group. People are motivated to act in the way they do out of biases deeper than an urge to maximize their wealth, reputation, or another measure of well-being. They are concerned about many other factors, such as how peers perceive them, and they make decisions in many cases based on what will be acceptable to the group. Moreover, most people stick to their decision, even if the decision turns out to be wrong-headed, long after they figure that out. These group dynamics, however, are only now getting significant attention in the literature regarding gatekeeper reform. Focus on the individual, as opposed to the group, pervades our system of justice. Our system determines the guilt of an individual actor [James A. Fanto, (2005)]. It is consistent with the emphasis in corporate law on discrete rational individuals acting to maximize their wealth [Daniel J.H. Greenwood (2005)]. Ignoring group dynamics, however, is inconsistent with the way individuals operate in a business environment. This observation is not new. Law and economics scholars, often criticized by proponents of social psychology, recognized long ago that the nature of the corporation could be best understood by placing the individual into the group and recognizing the role of the individual within it [Frank H. Easterbrook & Daniel R. Fischel, (1991)]. Ignoring group dynamics leads one back to a rational actor model of individualized action and stresses a "bad apples" approach to understanding corporate wrongdoing [John M. Darley (2005)]. It deemphasizes the influence one person or group of persons has on another, such as the interaction of a board of directors or the relationship between and among gatekeepers and their principals. This de-emphasis elides the complicated causes of misbehaviour and may prevent meaningful reform.

Second, analysts of gatekeeper liability have ignored specific root causes of corruption. Corruption can begin with certain small steps that "have their origins in actions that are not themselves corrupt." Small or insignificant actions can spread within an organization, with each subsequent actor rationalizing that their conduct is not much different from conduct that preceded it. If this is correct, wrongdoing cannot be alleviated in large organizations by screening out individuals deemed corrupt. The problems are deeper because many or most people are susceptible to the kinds of actions they ultimately might brand as wrong.

Moreover, even if one is not susceptible to committing an action that could be considered corrupt in hindsight, conventional analysis has not accounted for how loyalty in an organization can cause some persons to fail to question others. A related frequently ignored concern is the haste with which individual decisions in large organizations are often made. This phenomenon is masked by the time it takes for tangible results to be achieved, such as introducing a new product or service. However, hundreds of thousands of more minor decisions are made within an organization to achieve the tangible result, often with little or no reflection. John Darley has explained that wrong decisions "may be overridden by the more deliberate thinking of the reasoning system, but only if something triggers that system into action."

Third, in addressing gatekeepers' behaviour, ideas of agency cost theory and the nexus-of-contracts approach are overemphasized. This approach focuses on purported contractual relationships, such as an individual director and the corporation. It recognizes that a director's interests may diverge from the shareholders' and it considers ways shareholders can ensure that a director's interests are aligned with shareholders' interests. Under this view, a manager or director's fiduciary duty is nothing more than a safeguard to ensure he makes the right decisions on behalf of investors, as the residual claimants of the firm [Frank H. Easterbrook & Daniel R. Fischel, (1983)]. However, the individualism characteristic of the contractualist view is inconsistent with board experience and fails as an explanatory theory of the recent business failures [Rakesh Khurana & Katharina Pick (2005)]. Finally, conventional analysis remains primarily wedded to a "command and control" (as opposed to a self-regulatory) corporate governance model. Where a command and control model relies on external sanctions and rewards, a self-regulatory model relies on shaping employees' internal motivations [Tom R. Tyler, (2005)]. Behavioural and social psychologists have shown that people are not profit maximizes [Marius Aalders & Ton Wilthagen, (1997); Neil Gunningham & Joseph Rees, (1997); Andrew A. King & Michael Lenox, (2000); Clifford Rechtschaffen, (1998); Darren Sinclair, (1997)); Melvin Aron Eisenberg, (1995 Jon D. Hanson & Douglas A. Kysar (1999) Cass R. Sunstein, (1997)].

b. Social Psychology

Lessons from sociology bridge psychology, which emphasizes the mental processes and behaviour of the individual, and sociology, which emphasizes social structure, social institutions and processes, and human interaction. In general terms, social psychology addresses the influences people have on the beliefs and behaviour of others. Much of the work in this area focuses on an

individual's behaviour in a social environment and motivations that affect the individual's decision making [E.F. Borgatta, (3d ed. 2001); Michael A. Hogg (2005)]. It is a broad field with, by one count, some 600 theories to explain human behaviour. The research suggests that unconscious bias can affect gatekeeper decisions. Social psychology teaches that goals and motives influence reasoning—the way people process information and their judgments. Motives affect reasoning by inducing people to rely on a limited set of cognitive processes that reflect the goals we seek to achieve. Cognitive processes that can become corrupted include how one accesses information and constructs and evaluates beliefs [Ziva Kunda, (1990)].

Gatekeeper decisions also can be biased because of a related reliance on heuristics, which are shortcuts or rules of thumb we use all the time to aid decision making. Most work in the area of heuristics and biases concerns facts. Heuristics, however, also are used in moral and legal decision making [Cass R. Sunstein (2004)]. By utilizing heuristics, one can avoid the complex cognitive work of receiving, understanding, and interpreting complex information and analysing the costs and benefits of alternative courses of action [Jennifer S. Lerner & Philip E. Tetlock, (1999); Philip E. Tetlock, Linda Skitka & Richard Boettger (1989)]. Heuristics work well most of the time, but not always [Amos Tversky & Daniel Kahneman, (1974); (Daniel Kahneman et al. eds., 1982)]. They fail us when a generalization that results from a heuristic is taken out of context and used as a universal principle where it no longer applies.

c. Reducing Dissonance

Psychologists explain that goals and motives influence reasoning because people seek to maintain consonance between relevant cognitions. The lack of consonance, or dissonance, produces pressure to avoid situations and information that increase the dissonance. One type of dissonance is post-decisional dissonance, which arises where a person must choose between two alternatives with positive and negative features [J.B. Campbell (3d ed. 2001); Leon Festinger, (1962) (1957)]. Most people typically choose the alternative that will result in less, not more, dissonance after the decision is made. In making such decisions, research demonstrates that reasoning can be driven by accuracy goals on the one hand or directional goals on the other. When one has accuracy in mind, the motive is to arrive at an accurate conclusion. When one has a directed goal in mind, the motive is to arrive at a particular conclusion. Accuracy goals yield better reasoning; directional goals yield strategies intended to reach a conclusion desired.

The distinction between accuracy and directional goals goes to the core of the difference between independent and dependent gatekeepers discussed in Part I.

Independent gatekeepers should be concerned with accuracy. They owe duties of objectivity and accuracy to the public. They should not be motivated by the clients' goals and end in the same way dependent gatekeepers are. Dependent gatekeepers, by contrast, are interested in reaching a particular result. A dependent gatekeeper, as discussed in Part I, must act for the client's benefit, furthering its ends and presenting the client in "the most favourable possible light [the United States v. Arthur Young & Co., (1984)]."

d. Motivational Goals

This section discusses mechanisms that result in thought processes to reduce dissonance related to accuracy versus directional goals that arise in the context of group dynamics. The focus is on two mechanisms—accountability and commitment—that are likely to bear on gatekeepers' decisions and that likely bear differently on dependent and independent gatekeepers as well as related heuristics that may lead to bias.

Accountability

a. The Perils of Accountability in Decision Making

Generally, accountability refers to an expectation to justify one's beliefs, feelings, or actions to others [Karen Siegel-Jacobs & J. Frank Yates, (1996)]. Accountability enhances accuracy because people who are held accountable will avoid making arbitrary or incorrect decisions. Politicians, teachers, supervisors, and colleagues are often called upon to be more accountable. They are providing compelling justifications results in positive ones. But researchers have uncovered a negative side to accountability as well. Failure to provide sufficient justification for a decision can result in negative consequences. Accountability, in some cases, can negatively affect the formation of attitudes and the accuracy of judgments. One way to understand accountability is that it acts as a constraint on everything we do. Constraint caused by accountability can lead people to censure particular views and short-circuit their decision process, omitting essential considerations.

We short-change accuracy goals for the sake of directional goals. Students, for example, are asked to complete evaluations of faculty anonymously to ensure that the students will not be held accountable. Imagine how *inaccurate* evaluations would be if we told students they must affix their signature and justify their beliefs to the evaluation faculty. This example suggests that the effect of accountability on accuracy differs depending on whether the audience's views to whom one is accountable are known or unknown to the decision-maker. In the example, the audience's views (the faculty) are known to the decision-maker (the student)

because the student would be justifying her evaluation to the same faculty she is rating. People are generally motivated to seek approval from their audience and are biased in favour of conclusions that conform to their views. When the audience's views are known to the decision-maker before she forms an opinion, she will redirect her opinion to conform to them. Directional goals take over. People adopt positions that are likely to be pleasing to those to whom they are accountable. When the audience's views are unknown, conformity is not possible, and accuracy goals predominate. In that case, people are more likely to consider multiple objectives and engage in a more thoughtful, deliberate, self-critical analysis. As Jennifer Lerner and Philip Tetlock explain, "When participants expect to justify their judgments [to an unknown audience], they want to avoid appearing foolish in front of the audience.

They prepare themselves by engaging in an effortful and self-critical search for reasons to justify their actions." Thus, in our example, accountability could promote accuracy if we hold students accountable to an independent board whose views about the faculty were unknown. Psychologists call the acceptability heuristic, which is closely related to the motivation to conform one's views to a general audience. Adopting the position of one's audience circumvents hard cognitive work. Studies demonstrate that when participants were unaware of the audience's views, they engaged in more complex information processing [Serena Chen, David Shechter & Shelly Chaiken (1996)]. When one expects to discuss one's views with an audience whose views are known, one will shift attitudes toward those of the audience, even if the results are inefficient. People do this in several ways. One possibility is to rely on irrelevant information in making a decision. In one study, when asked to predict grade point averages of a student audience, accountable participants short-circuited their reasoning and relied on irrelevant information, such as the number of plants a student keeps, as opposed to the number of hours the student studied. It allowed the participants to pursue their directional goals—predicting high GPAs—at accuracy's expense.

b. Accountability and Gatekeeper Bias

How do accountability and audience views bear on decisions made by independent and dependent gatekeepers? Independent gatekeepers should be accountable to an audience whose views are unknown. The audience for independent gatekeepers, such as auditors and analysts, is a diverse public with heterogeneous views. Financial statements, for example, are necessary not only for management to get a complete snapshot of the company's affairs but also for use by creditors, suppliers, analysts, employees, competitors, and, perhaps most importantly, public investors. While some may wish to see a clean opinion from an auditor or a "buy"

recommendation from an analyst, others may want the opposite. Empirical studies of auditors confirm that when audience views were known, auditors were animated by directional goals and conformed their conclusions to them. When the views were unknown, auditors were accuracy-oriented and engaged in a more deliberative process. While the issuer may retain an auditor, it must conduct itself independently of the issuer. As Robert Haft has explained, "There is a greater tendency for courts to decide that a duty to disclose material facts to non-client investors exists for accountants than for attorneys . . . ." [Robert J. Haft, (1995)] Similarly, analysts should be independent of the companies they research and should present the company to the public in an objective fashion. These gatekeepers cannot know the views of their audience as the audience comprises public investors.

Dependent gatekeepers, by contrast, are accountable to an audience whose views are known, the clients who hired them. The lawyer's primary audience is his client; the same is true for an underwriter. As discussed in Part I, dependent gatekeepers advocate on their clients' behalf and, in some cases, owe them fiduciary duties. The dependent gatekeeper is charged with furthering the client's goals, which the gatekeeper appreciates and understands because the purpose of his engagement is to promote those goals. Sung Hui Kim refers to lawyers' "ethical ecology," explaining that "alignment pressure can distort the lawyer's judgments." Underwriters, while subject to section 11 liability, assume a substantial risk if an offering fails. Thus, while the underwriter's dependence may not be as clear as the lawyer's, the underwriter faces alignment pressure just like the lawyer. By contrast, lawyers are exempt from section 11 liability— Congress simply did not include them in the list of potential defendants.

Moreover, lawyers generally are accountable to their clients, not third parties, for their legal opinions [Jay M. Feinman (1996)]. As one court stated, "The law, as a general rule, only rarely allows third parties to maintain a cause of action against lawyers for the insufficiency of their legal opinions." The comment to the relevant section in the Restatement of the Law Governing Lawyers explains, "Making lawyers liable to non-clients, moreover, could tend to discourage lawyers from vigorous representation. Hence, a duty of care to non-clients arises only in… limited circumstances." Thus, in the case of dependent gatekeepers, the audience's views are known, and the gatekeeper has a strong desire to maintain views consistent with them.

Commitment

a. Commitment and Bias

Once people commit to a course of action, they tend to escalate their enthusiasm. Even after it becomes clear that the disadvantages of pursuing a course of action outweigh the advantages, people refuse to let go. "Groups may stick to a consensus view, even in the face of changing information, because consensus assures them their assessment or decision is correct." Social psychology teaches that when an individual is a group member committed to the purposes and tasks of the group, the task of the individual is first to become a "prototypical member of that group, and then help the group as best she can in reaching its goals." Moreover, after committing to a decision, people are highly motivated to avoid self-criticism and justify their original decision if called upon to justify the choice. Studies show that subjects concern themselves with thinking up as many reasons for why they were right and their critics wrong. Psychologists refer to this as *retrospective rationality or defensive bolstering*.

The presence of commitment marks an important distinction between independent and dependent gatekeepers and between accuracy versus directional goals. Commitment to the principal's interests is the cornerstone of the fiduciary relationship, which, as discussed, describes the link between dependent gatekeepers and their principals. Dependent gatekeepers, as fiduciaries, owe a duty of loyalty to their clients to act on their behalf. They are directed to advance the client's lawful interests and must single-mindedly pursue those interests. The traditional model of lawyering often is referred to as the *total commitment* model [Marie A. Failinger (1999); Roger C. Cramton, (1985); Roger C. Cramton, (2002); Charles P. Curtis, (1951)].

To see how commitment might take hold, consider the role of gatekeepers in a securities offering. The process begins with the issuer, who will look to an investment bank as a lead underwriter. The lead underwriter will investigate the issuer and decide whether to underwrite its securities. After the issuer and underwriter sign a letter of intent, the underwriter's experts and its lawyer's labour, along with the issuer and its attorneys, understand the company from several perspectives and assess its prospects. The effort is a joint commitment by the issuer, the underwriter, and their respective lawyers [Harold S. Bloomenthal & Sam Wolff, (West 2004)]. They have a joint stake in seeing the project through; they share the same directional goal. This group dynamic is vital to understanding gatekeeper behaviour. The role of the auditor, however, is more circumscribed. After undertaking its own investigation, the auditor issues a certificate under its name as to the accuracy and completeness of the financial statements—the goal is

accuracy. Commitment, once established, can affect decision making in several ways. Continuing with the example of an offering, it is likely that the decision to participate entails some dissonance because not all aspects of an engagement are likely to be positive, and most transactions entail some risk. After making decisions, one-way people reduce dissonance is to reassure themselves they made the right choice by focusing on information that will lead them to that conclusion. Once a dependent gatekeeper has agreed to an engagement, he has committed himself to the client's ends and is more likely to focus on positive aspects of the choice and downplay negative ones.

This commitment has significant consequences. After executing an underwriting agreement, which generally occurs immediately before the offering closes, an underwriter must continually assess whether the prospectus should be updated or revised not to be materially misleading. However, since directional goals predominate over accuracy goals, an underwriter committed to the transaction has an incentive to filter information to avoid amending the registration statement with negative information, which would impede selling efforts [John J. Jenkins, (1999)]. It was the context of the famous case of *SEC v. Manor Nursing Centers, Inc.* The court held that the appellants, including the underwriters, were duty to amend the prospectus to reflect developments after the SEC declares the registration statement effective. The failure to do so was a violation of the registration provisions and the anti-fraud provisions [Joseph McLaughlin, (2006)].

b. Commitment to Outcome Versus Process

Recent research bridging accountability and commitment reinforces the negative relationship between commitment and accuracy. This line of research distinguishes outcome accountability from process accountability. Outcome accountability is accountability for the outcome of a decision; it is goal-directed. Process accountability is accountability for the quality of the process used to arrive at a decision. Outcome accountability increases commitment to previous decisions about what the outcome should be and leads to defensive bolstering. Outcome-accountable subjects in decision making displayed what is known as more scatter (the presence of irrelevant judgments) than subjects who had to account for procedures or subjects who were not accountable.

Process accountability, by contrast, leads to a better decision-making process, such as more consideration of alternatives and less self-justification. If justification focuses on the process used to make judgments, then accountability can be helpful. Outcome accountability, however, had no beneficial effects whatsoever and was harmful compared to no accountability [Tom R. Tyler &

Stephen L. Blader (2000)]. The distinction between outcome and process accountability mirrors the distinction between directional goals and accuracy goals. The distinction between outcome and process accountability explains the rules concerning gatekeepers discussed below, and it demonstrates the difference between them. Independent gatekeepers are not held accountable for outcomes in the same way dependent gatekeepers are. Special protections exist for independent gatekeepers—particularly auditors— when the client disagrees with the outcome. It is difficult for a public company to terminate an auditor when the client disagrees with the outcome. Terminating an auditor is a public event and must be reported on an SEC form designed to disclose certain material events when they occur. No such protections exist for lawyers.

The dependent gatekeeper's commitment to outcome is closely related to a heuristic called *anchoring and adjustment*. Anchoring and adjustment describe the phenomenon that, in making decisions, we begin with a starting point and adjust our estimates upward or downward insufficiently relative to where we started. Insufficient adjustments result in bias. If a sale item costs $1 and the sign says "limit 10 per customer," you are more likely to leave with seven or eight, although you need only one.162 Similarly, when executives forecast a project's completion, they adjust the estimates based on new information, but they prepare the original estimates making their success case, which skews subsequent forecasts toward optimism [Dan Lovallo and Daniel Kahneman, (2003)]. Dependent gatekeepers are likely to be more prone to bias through anchoring and adjustment than independent gatekeepers. Think again about the offering example. The issuer and its lawyers are the ones who generally draft the initial version of a registration statement [Bloomenthal & Wolff, Johnson & Mclaughlin, Escott v. BarChris Constr. Corp., (S.D.N.Y. 1968)]. In doing so, they are preparing a document they hope will result in a successful distribution. With the assistance of the underwriters, they come up with an initial draft that will then be adjusted based on comments from third parties and the SEC staff. However, the initial draft of the registration statement serves as the anchor, and any amendments must be justified as departures from the original.

Accountants performing an annual audit or analysts researching a public company do not have the same anchors to contend with. They are not wedded to the issuer's numbers. Under Auditing Standard No. 2, auditors must obtain independent evidence, employ professional scepticism, and use the work of others only in limited circumstances. The same is valid for analysts. Instead of using financial data provided by an issuer as an anchor, an analyst may choose instead to use industry averages against which to measure an issuer's performance. In that regard, an underwriter may seek out analysts' views, in the context of an offering,

to learn of the strengths and weaknesses of the competition [Johnson & Mclaughlin (2003)].

Given that dependent gatekeepers are accountable to their principals and committed to furthering their ends, careful consideration should be paid to how directional goals and bias may affect their decisions. One cannot ignore the powerful draw that motivations have on judgment and the unconscious bias that can result. Moreover, simple heuristics like acceptability and anchoring can bias judgments as well. If gatekeepers' decisions about whether to stop a transaction from going forward or report wrongdoing to a third person were clear-cut, one would have little cause for concern. Such decisions, however, are highly indeterminate. Part III addresses the indeterminate nature of such decisions and, drawing on the above, what to do about them.

Reforming Gatekeeper Bias

The observations in the earlier section advance the understanding of gatekeeper behaviour. This Part considers recent and potential reforms. The discussion so far suggests two possible paths for reform. One path is to discount the work of dependent gatekeepers. To the extent they are charged with promoting their clients' ends, as discussed in an earlier section, they are prone to directional goals instead of accuracy goals, as discussed in earlier sections, and destined to fail. It appears to be the path suggested by some commenters, who discuss shrinking the scope of underwriter liability [John C. Coffee, Jr., (1997); Donald C. Langevoort (2000)]. Another path is to expand the scope of liability of dependent gatekeepers precisely because of the biases discussed. The observations in Parts I and II regarding the differences among gatekeepers and the tendency to self-justify are magnified because of indeterminacy in the law. One result of indeterminacy is that when one wants to reach a particular result, one often can reach it and then defend the result as reasonable. It is not true to the same degree for independent gatekeepers. While auditors face some ambiguity in the course of an audit, as a general matter, auditors use relatively objective rules that contain few principles and standards, leaving wide latitude for interpretation. If managers sought to influence financial statements improperly, Generally Accepted Accounting Principles (GAAP) inhibit such conduct even if the auditors were willing to oblige. This Part, therefore, begins with a discussion of the indeterminacy inherent in the corporate and securities area.

a. Indeterminacy in Corporate and Security Law

Securities and corporate law are inherently ambiguous for several reasons. First, notwithstanding many technical provisions, the responsibilities of issuers and

market professionals often turn on state common law fiduciary duties—a notoriously ambiguous area of the law [Ehud Kamar (1998); Marcel Kahan & Ehud Kamar, (2001)]. It is particularly true for the duty of care, which is an open-ended requirement to exercise the care and skill of an ordinarily prudent person. Courts, particularly in the corporate law area, recognize that the duty to pay attention to corporate matters is inherently ambiguous. In Barnes v. Andrews, Judge Learned Hand remarked, the measure of a director's duties in this regard is uncertain; the courts contenting themselves with vague declarations, such as that a director must give proper attention to the corporate business. The latitude inherent in the duty of care is embodied in the business judgment rule, which provides that, in the absence of fraud or bad faith, courts will not second guess directors' decisions if they turn out badly [Dennis J. Block, Nancy E. Barton & Stephen A. Radin, (5th ed. 1998)].

1. Standard of Care

The ambiguity of the duty of care renders the gatekeeper's responsibilities highly indeterminate. Under the Securities Act of 1933, the underwriter (and others) can defend against a liability claim if it conducts a "reasonable investigation" into the facts disclosed in the registration statement. However, there is little or no guidance on what a reasonable investigation entails, and few litigated cases have been decided on this point. The leading case, *Escott v. Bar Chris Construction Company*, is nearly 40 years old and, in that case, the court stated, "There is no direct authority on this question, no judicial decision defining the degree of diligence which underwriters must exercise to establish their defence under Section 11." The court could not arrive at a rule: "It is impossible to lay down a rigid rule suitable for every case defining the extent to which such verification must go. It is a question of degree, a matter of judgment in each case." More recent cases addressing whether due diligence should be decided by a judge or jury make the same point. In the end, the standard required for due diligence under the Securities Act is the vague duty of care. This standard is now codified in section 11(c) of the Act, which reads, "In determining . . . what constitutes a reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his property."

2. Materiality Requirement

The law is hard to pin down because at the heart of every disclosure requirement and every claim of fraud under the securities laws is a materiality requirement. The materiality standard turns on the following: [Whether] there is a substantial

likelihood that a reasonable shareholder would consider it important in deciding how to vote . . .. Put another way, and there must be a substantial likelihood that the reasonable investor would have viewed the disclosure of the omitted fact as having significantly altered the "total mix" of information made available.

The standard is ambiguous. It depends on what a reasonable investor would decide, which often depends on how a particular judge or regulator views the facts [Yvonne Ching Ling Lee, (2004)]. Attempts to quantify materiality or provide a bright-line rule have been rejected [Staff Accounting Bulletin (Aug. 19, 1999)]. In Basic Inc. v. Levinson, the Supreme Court rejected a bright-line rule to determine when merger negotiations would be considered material, stating that "ease of application alone is not an excuse for ignoring the purposes of the Securities Acts and Congress' policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality must necessarily be over-inclusive or under-inclusive [Basic, Inc. v. Levinson, 485 U.S. 224, 236 (1988)].

3. Form of Rules

In addition to these substantive points, corporate and securities law is indeterminate because of the rules themselves. First, securities regulation is often promulgated through standards as opposed to bright-line rules. The conventional distinction between rules and standards is that rules are clear cut and set forth the law ex-ante, whereas standards provide only general principles that judges can apply to a particular set of facts. Rules constrain judicial discretion more than standards. However, standards are common in the securities area. A frequent criticism about the SEC is that it has always resisted bright-line rules to preserve flexibility in enforcement cases. The SEC in many cases, refuses to adopt bright-line rules and instead provides factors that apply flexibly depending on the facts. For example, in the due diligence context, the Commission sought to guide Securities Act Rule 176. In doing so, however, the Commission only set out factors to be considered to determine whether due diligence was met. The rule is inconclusive, and the Commission explicitly left the ultimate conclusion regarding the satisfaction of due diligence to the courts.

A second reason the form of rules in the securities area leads to ambiguity is that litigation is rare. In many cases, rules are pronounced through settled enforcement cases instead of through litigated cases or administrative rulemaking. Most SEC actions and many state law corporate cases, particularly in Delaware, are settled. A legal rule announced through a settlement necessarily lacks the level of specificity that would attend a decision after a litigated case on the merits with a fully developed record. Moreover, when cases do not settle, many are decided

at a preliminary stage in the proceedings where the record is not fully developed. Such opinions are likely to be more indeterminate than cases decided later in the proceedings when the record is complete [Jill E. Fisch, (2000)]. Finally, a settlement sidesteps the need for the government to articulate the legal theory on which the action is based and leaves potential questions about its precedential effects.

Indeterminacy has important implications for gatekeepers. Consider two examples of the kinds of decisions gatekeepers must make. First, under new SEC rules governing attorney conduct, the duty to report "up the ladder" is triggered when the attorney "become[s] aware of evidence of a material violation" by the issuer. Material violation is defined as "a material breach of fiduciary duty [Investment Company Act Release No 25,919, 68 Fed. Reg. 6296, 6296 n.7 (Feb. 6, 2003)]. The attorney, therefore, must interpret what constitutes "evidence," what constitutes a "violation" and whether the violation is "material." Since the definition of violation includes a breach of fiduciary duty, the attorney is left to determine when a fiduciary breach has occurred. Second, in the context of public offerings, the underwriter must determine whether the registration statement "contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading [Securities Act § 11, 15 U.S.C. § 77k(a) (2000)]" The underwriter, therefore, must determine when a fact is "untrue," whether it was "material," or whether an omitted fact was "required" or necessary to make other statements "not misleading." In these cases, the gatekeeper consciously or unconsciously may conclude acceptable to the client because of ambiguity in the law.

Finally, it is essential to distinguish the ex-ante from the ex-post perspectives when assessing gatekeepers' conduct. From an ex-post perspective, one could always argue that gatekeepers' actions or inactions were *inappropriate* because they assisted the client with a wrong end. From an ex-ante perspective, a dependent gatekeeper has other values to consider. One such value is client autonomy. The legal system accommodates individual autonomy by giving significant latitude for individual decision making above a floor of clear illegality [Stephen L.Pepper, (1986)]. Dependent gatekeepers have multiple considerations in deciding whether to "report up" in the organization or force an issuer to make certain disclosures. As mentioned, federal securities laws do not require disclosure of all material information; disclosure is only required if an omission renders something that was said misleading. If the attorney discovers something wrong, it must not necessarily be disclosed. It is precisely in the vagary of determining whether the omission is necessary to render other information not misleading that the gatekeeper's biases are likely to take hold.

Section VI: Multiple Corporate Gate Keeping

Gatekeepers and Business Transactions

This Part describes the paradigmatic conception of the gatekeeper as a unitary actor. It then explains the multiple gatekeeper phenomenon, analysing why gatekeepers exist in the context of business transactions and why corporations rely on a multiplicity of gatekeepers in a single business transaction. It then describes potentially adverse consequences arising from the phenomenon.

a. The Unitary Gatekeeper

In laying the theoretical foundation for gatekeeper liability, Reinier Kraakman conceived of the gatekeeper as an actor with the capacity to monitor and control, or at least to influence, the conduct of its corporate client and thereby deter wrongdoing (Reinier H. Kraakman, (1984). Drawing on Gary Becker's seminal work on the economics of crime and punishment [(Gary S. Becker, (1968). Professor Kraakman framed his inquiry as a search for external legal controls that would "yield the 'right amount of compliance with legal rules—bearing in mind that enforcing these duties is itself costly (Kraakman, 1983). He conceived gatekeepers as occupying a position within the larger legal framework and regarded liability as a mechanism to ensure the optimal deterrence of corporate wrongs. In this framework, wrongdoing could be directly deterred by the imposition of liability on corporations and individual corporate managers. Only where supplemental deterrence was required were gatekeepers to face potential liability to provide incentives for them to exercise their ability to monitor and control. Gatekeepers were thus considered in terms of their capacity to deter corporate wrongdoing.

Since Professor Kraakman's pioneering work, scholars have either modelled the liability of a single gatekeeper or analysed the liability of each of several gatekeepers independently of one another. In early work, Howell Jackson considered the possibility of imposing gatekeeper liability on lawyers in the context of advising financial institutions [(Howell E. Jackson, (1993)]. Stephen Choi developed an analytical framework for the role of gatekeepers, taking into account variations in the accuracy with which they monitor and control client conduct [(Choi (1998)] and applied the framework to the position of underwriters in securities offerings. John Coffee, in his book *Gatekeepers*, traced the historical evolution of numerous gatekeeping professions and considered, for each, reforms that would improve the gatekeeping effectiveness of these actors [(John C. Coffee, Jr., (2006)]. Assaf Hamdani modelled the paradigmatic relationship between a gatekeeper and a client and warned of the adverse selection problems that may arise where a gatekeeper cannot distinguish among its clients based on

their potential wrongdoing. Numerous other vital contributions have been made (Lawrence A. Cunningham, (2007). Scholars, however, have yet to question the unitary conception of the gatekeeper and, correspondingly, have failed to recognize the interdependencies existing among multiple gatekeepers in terms of their capacity to deter corporate fraud. Professor Kraakman notes that wrongdoing might be deterred by "an interacting network of gatekeepers," at least for complex offences. He does not, however, pursue the insight. Professor Hamdani also observes that legal regimes should consider "market-specific characteristics," such as the "presence of multiple gatekeepers." Hamdani further observes that the presence of multiple gatekeepers "complicates the task of designing an optimal regime of gatekeeper liability" in the context of securities fraud, but notes that the "risk is somewhat mitigated because the third parties involved can often contract privately to ensure that the party best positioned to ensure compliance will ultimately incur the cost of liability."

b. The Multiple Gatekeeper Phenomenon

A pattern of multiple gatekeeper involvement characterizes business transactions. Typically, a corporation will engage a law firm, an accounting firm, and an investment bank (Charles R. Geisst, (1995)—and often several of each—to assist it whenever it undertakes a business transaction of any significance [(James D. Cox et al., (6th ed. 2009)]. Investigating this phenomenon involves asking two questions. First, why do corporations rely on the market for gatekeeping services at all? Why do corporations choose to "buy" these inputs into the transactional process rather than "make" them? Second, having decided to rely on the market for gatekeeping services, why do corporations rely on multiple distinct gatekeepers (F.M. Scherer & David Ross, 1990).

Differentiating Gatekeepers

Collective blame for recent business failures has fallen on gatekeepers. The conventional view is that auditors, lawyers, underwriters, analysts, and others have shirked their responsibilities and permitted illegal conduct. If we clarify and enhance the responsibilities of gatekeepers, some say we will avoid such debacles in the future [Bank of America Corp., (Feb. 4, 2010)]. This claim traditionally depended on a rational actor model. A gatekeeper would prevent misconduct by a primary violator because the gatekeeper's expected liability or reputational harm from failing to prevent misconduct exceeded the benefits gained in fees [Report of the New York City Bar Association (2007)]. Because investors understand a gatekeeper would not act irrationally, his statements are to be believed [John C. Coffee, Jr., (2004) Frank Partnoy, (2004); John C. Coffee, Jr., (2004); Assaf

Hamdani, (2003); Reinier H. Kraakman, (1986); Frank Partnoy, (2001)]. While this model has merits, it fails to distinguish among gatekeepers, likely to respond differently to incentives. It also fails to appreciate differences in the character of a gatekeeper's relationship with a primary violator and to consider whether such differences bear upon gatekeeper behaviour.

This section examines gatekeepers by focusing not on their similarities but their differences. All gatekeepers are not alike. They vary widely in their functions, skills necessary for the job, relationships with their principals, and duties they owe. There are differences in their approaches as well. Accounting determinations, for example, are often formalistic and unambiguous, while legal advice is said to be more nuanced, requiring an attorney to explore a range of options with a client, who evaluates the lawyer's advice and then makes up her mind. The securities analyst, unlike the accountant or lawyer, makes predictions, which are frequently wrong. Distinguishing among the character of gatekeepers' evaluations is helpful, but it masks more considerable differences in the structure of gatekeepers' relationships with their clients.

This section focuses on one difference in the particular that bears closely on whether the gatekeeper can be effective: whether, as a normative matter, the gatekeeper is meant to be independent of the client, acting as a neutral umpire [Dodd-Frank Wall Street Reform and Consumer Protection Act, (2010)], or whether the gatekeeper is meant to be dependent on the client, charged with promoting the client's ends in a fiduciary or similar capacity. The label dependent is used because certain gatekeepers depend on the client to determine their agency's nature, purpose, and scope. Distinguishing between independent and dependent gatekeepers, however, is only a starting point. One also must ask why gatekeepers have not been more robust monitors. At least part of the answer is that the conventional view of the gatekeeper's role is inadequate, focusing on the actions of a single individual rather than the dynamics of the group. Similarly, until recently, Congress, regulators, and courts have relied mainly on a command and control philosophy of governance, rather than addressing biases that can cause one slight misstep but lead incrementally to large scale disasters. Thus, rather than looking at the gatekeeper problem from the perspective of a rational actor, this paper explores it from a behavioural viewpoint.

Harnessing Multiple Gatekeepers Optimality

This Part describes optimal deterrence theory, the prevailing paradigm for considering gatekeeper liability. It then provides a case study involving multiple gatekeepers and develops a simple taxonomy of interactions among gatekeepers that serves as a basis for extending the literature on gatekeeper liability.

A. Optimal Deterrence Theory

1. General Principles

Securities fraud compromises the accuracy of the price of the corporation's securities relative to its fundamental value (Marcel Kahan, 1992). Moreover, thereby reducing social welfare. In the present context, securities fraud concerns intentional, material misstatements or omissions in corporate disclosure in the course of a business transaction (although, of course, securities fraud may also occur outside this context, such as in connection with a corporation's periodic reporting requirements). For securities offerings, in particular, securities fraud typically takes the form of misstatements or omissions in offering documents provided to investors to induce them to purchase the securities. Investors' anticipation of trading on unfavourable terms, rather than simply the existence of inaccurate prices, reduces social welfare (Amanda M. Rose, 2010). Anticipating unfavourable terms, investors may discount the price they are willing to pay for securities. It would increase corporations' cost of capital, leading to its misallocation among corporations and alternative uses (Frank H. Easterbrook & Daniel R. Fischel, 1984). In the secondary market, investors may be reluctant to trade at all. It would reduce securities' liquidity, increase transaction costs, and possibly lead investors to hold non-optimal portfolios. Merritt Fox explains that securities fraud may also reduce the effectiveness of corporate governance mechanisms (Merritt B. Fox, 2009) and may distort a corporation's investment decisions, leading it to reject socially desirable investment projects or accept socially undesirable projects.

Optimal deterrence theory prescribes the legal rules that optimally deter socially harmful conduct. Developed by Steven Shavell and others [(Steven Shavell. 2007, 1987); Guido Calabresi, (1970)] the theory predicts how particular rules of liability will affect the conduct of actors and makes normative claims as to the desirability of those rules based on a particular criterion of social welfare. In predicting the conduct of actors, the framework draws on the expected utility theorem and decision making under risky conditions. It adopts the standard neoclassical assumption of complete and perfect rationality by actors. Accordingly, actors are assumed to behave as if they evaluate and choose among expected consequences at no cost [(Kenneth J. Arrow, (1970). After evaluating expected consequences based on their expected utility, actors will act as if to maximize their expected utility (Steven Shavell. 2007, 1987); Guido Calabresi, (1970)]. In making normative claims about the desirability of legal rules, optimal deterrence theory adopts the social goal of minimizing the sum of the expected social costs of the wrongdoing, the costs of precautions, and the administrative costs associated with enforcement.

Since administrative costs—the costs associated with "detecting, prosecuting, defending, and adjudicating securities fraud cases"—are not within the control of actors, they are set aside for present purposes (although they must, of course, be considered in determining optimal arrangements). Where legal rules lead actors to satisfy this criterion—to minimize the expected social costs of the wrongdoing and the costs of precautions—optimal deterrence is achieved. Acting optimally, actors would, in effect, bear the costs of precautions until their marginal costs exceed the marginal reduction in the costs of expected wrongdoing (David Rosenberg (1987). It follows from the theory that conduct should not be regulated simply because it reduces social welfare (John C. Coffee, Jr., Market (1984). Regulation is costly and desirable only where the social welfare criterion would be satisfied. For similar reasons—because precautions are costly—the optimal level of precautions may not be that which prevents the wrongdoing or even minimizes its probability. Again, this is because desirable precautions are those under which the social welfare criterion would be satisfied. Applying the theory requires that liability rules be finely calibrated: adopting more extraordinary precautions would over-deter securities fraud, just as adopting lesser precautions would under-deter securities fraud.

2. The Gatekeeping Context

As explained above, gatekeepers occupy a position within a broader legal framework. Since a corporation is simply a fictional person, an individual or individuals perform the relevant acts comprising securities fraud. The fraud may be deterred directly by the imposition of potential liability on the corporate enterprise, as well as on individual corporate managers. Such liability would create incentives for the corporation and its managers to take precautions to exercise their control over individual wrongdoers. The fraud may also deter gatekeepers, who have existing incentives—even without those created by gatekeeper liability—to monitor and control corporate conduct. As repeat players expecting to engage in future transactions, gatekeepers have incentives to build and preserve good reputations since a good reputation will enhance a gatekeeper's prospects of acting on future transactions. The reputational mechanism operates to produce incentives for gatekeepers to certify the disclosures of their clients diligently and honestly. Gatekeeper liability would only be desirable to supplement enterprise liability and individual managerial liability where these more direct forms of liability and reputational constraints fail to provide sufficient deterrence (Victor P. Goldberg, (1988). The standard case where gatekeeper liability is desirable arises where the corporation is insolvent. More direct forms of liability would likely then fail to produce sufficient deterrence.

Having situated the gatekeeper in the broader regulatory context, let us now focus on identifying the liability regime that would induce gatekeepers to take optimal precautions to deter securities fraud. Securities fraud is intentional wrongdoing, and individuals are therefore assumed to avoid it without cost. By taking precautions, gatekeepers exercise their capacity to monitor and control the corporation's conduct. As depicted by the diagram above, gatekeepers may exercise this power over both corporate management and other corporate employees. Applying optimal deterrence theory first requires predicting the gatekeeper's response to particular liability regimes in terms of the precautions it takes. For a type of securities fraud, each gatekeeper must choose the particular level of precautions to take as she performs her gatekeeping functions. The probability of the fraud occurring will be a function of the level of precautions taken. Typically, the greater (or, the higher the level of) the precautions, the more likely the securities fraud will be deterred—that is, the lower its probability of occurrence. The gatekeeper must also weigh the cost of precautions. It will choose among levels of precautions—and thus the expected consequences (namely, the securities fraud occurring with a particular probability)—as if it were acting to maximize its expected utility. It will prefer one level of precautions to another only if its consequences yield a more excellent expected utility value. Applying the theory also requires the identification of liability regimes under which gatekeepers will be led to act optimally—that is, to take precautions that would minimize the sum of the costs of the expected wrongdoing and costs of precautions. An optimal regime would thus force gatekeepers to internalize the social costs of their clients' wrongdoing, providing incentives for gatekeepers to invest in a socially optimal level of precautions.

In practical terms, what are precautions for gatekeepers? Precautions represent the mechanisms through which gatekeepers exercise their control over the conduct of their corporate clients and include any activities that affect the probability of securities fraud in the form of disclosure misstatements or omissions. In business transactions they would include fraud-detection and fraud-prevention measures, such as the conduct of due diligence, discussions with management and other personnel about the corporation's operations, and attendance at meetings to draft the offering document. Precautions would also include verifying the information or advice of another gatekeeper and asking for changes to proposed corporate disclosures. In some cases, precautions would include shutting the "gate" to a transaction, such as refusing to provide a written opinion on which execution of the transaction is conditioned.

3. Analogy with Joint Tortfeasors

The position of gatekeepers is conceptually similar to that of tortfeasors. Both types of actors must determine what level of precautions to take to deter a particular securities fraud or accident, as the case may be. More specifically, the gatekeeper's position is akin to that of the accidental tortfeasor in a unilateral accident. The gatekeeping context is unilateral in the sense that the victims of any failure by gatekeepers to take adequate precautions—namely, the investors—do not contribute to the risk of securities fraud. Investors typically exercise no control over a corporation's disclosure decisions in business transactions. Gatekeepers' conduct is also more likely to be accidental than intentional. However, the analysis adopted in this Article—identifying liability regimes that will lead gatekeepers to adopt efficient precautions to deter harm—does not turn on a gatekeeper's state of mind (Posner, 2007). One potential distinction between tortfeasors and gatekeepers is that tortfeasors typically contribute to the risk of the accident because of their capacity to create it, whereas gatekeepers contribute to the risk of fraud by having the capacity to deter it. More specifically, gatekeepers contribute to the risk of corporate wrongdoing by having the power to monitor and control corporate conduct, which they may exercise by taking precautions. Thus, gatekeeper liability attaches not for gatekeepers' wrongs—although gatekeepers can indeed inflict harm directly on investors—but for the wrongs attributed to the corporation that could have been optimally deterred by taking precautions by gatekeepers. Gatekeepers' contribution to the risk of wrongdoing is the mirror image of that of most tortfeasors. In any case, for analytical purposes, a strong analogy exists between gatekeeper liability and tortfeasor liability in unilateral accidents.

4. Limits of Reputation

Gatekeeper liability would be desirable only where other deterrence measures, including the disciplining effect of reputation on gatekeeper behaviour, are insufficient. The effectiveness of reputation as a constraint on gatekeepers is subject to fundamental limits that are worth briefly exploring (Rachel Brewster (2009). One such critical limit concerns the informational content of reputation and its sensitivity to gatekeeper failure in past transactions. Given the nature of the gatekeeping role, the relevant firm reputation reflects its performance as a certifier of the accuracy of the disclosures of its corporate client—in other words, its reputation for honesty and diligence. However, information about past gatekeeper conduct may not be widely disseminated, and even where it is, it may not allow a reliable assessment of the gatekeepers' performance. In business transactions, much of gatekeepers' work is never publicly disclosed, and, when

allegations of securities fraud arise, most disputes settle before the underlying facts are fully ventilated in a trial [(Mitchell Polinsky & Steven Shavell, (2010)]. Even where facts are revealed, perceptions as to propriety differ, and difficulties exist in distinguishing between the conduct of the various actors. Moreover, gatekeepers may well rehabilitate their reputations by changing personnel or improving internal controls. All this suggests that reputations may not be well-calibrated to the quality of gatekeeper performance in past transactions and are thus noisy or crude indicators of gatekeeper performance.

A further potential limit on reputation as a deterrence measure arises because the relevant reputation for constraining misconduct is that of the gatekeeping firm, while the incentives of individuals at the firm may diverge from those of the firm. Since the interests of individuals may diverge from those of the firm, perhaps due to individuals' shorter time horizons, firm reputation will act as an imperfect constraint on individual conduct. Ultimately, though, whether the reputational mechanism is sufficient is an empirical question.

A. Multiple Independent Gatekeepers

In a business transaction involving multiple gatekeepers, gatekeepers will be independent for a particular type of securities fraud where that fraud would be optimally deterred by a single gatekeeper taking precautions. It is the world of the unitary gatekeeper that scholars have inhabited until now. Since optimal deterrence would be served by a single gatekeeper taking precautions, a regime imposing liability on that act alone would be desirable. Borrowing from tort law, that actor should be the "cheapest cost avoider," that is, the actor who can most effectively reduce the cost of accidents. In these circumstances, it would be desirable for the other actors to take no precautions, despite their involvement in the transaction.

A standard of either strict liability or fault-based liability would lead this gatekeeper to take optimal precautions to deter securities fraud. A rule of strict liability under which the lowest-cost gatekeeper would bear liability for all of the client's wrongdoing would be efficient since it would force the gatekeeper to internalize the social costs of that wrongdoing fully and thus adopt optimal precautions. A fault-based rule would also be efficient, provided the gatekeeper escaped liability only by adopting optimal precautions. Although both rules are efficient, some scholars prefer a rule of strict liability because it leads wrongdoers to engage in the optimal level of activity and relieves courts of determining what constitutes optimal precautions.

B. Multiple Interdependent Gatekeepers

Gatekeepers will be interdependent for a particular wrong where that wrong is optimally deterred by more than one gatekeeper taking precautions. This Section introduces a stylized example in which gatekeepers face a choice among sets of precautions. In consonance with optimal deterrence theory, the gatekeepers evaluate the expected consequences of each choice based on its expected utility and act as if to maximize their expected utility. A particular liability regime is optimal if it would induce gatekeepers to satisfy the social welfare criterion. The following liability regimes are considered:

1. Strict Liability

Consider first whether a regime under which multiple gatekeepers face strict liability for the corporation's wrongdoing would induce the gatekeepers to take optimal precautions. Under this regime, irrespective of fault, the gatekeepers would face liability for the wrongdoing of their corporate client. The gatekeepers must share the liability in some proportion, and because the fault is of no moment under a strict liability regime, they will do so in some fixed proportion unrelated to their respective contributions to the risk of wrongdoing (Lewis A. Kornhauser & Richard L. Revesz, (1989).

Under which liability is apportioned among gatekeepers on a fixed share basis, this regime corresponds to a rule of joint and several liabilities with a right of contribution (Liability Regime (i) above). Joint and several liabilities is a method of apportionment under which each gatekeeper is alternatively liable, at the plaintiff's option, for all or any part of the harm assessed. In other words, from the plaintiff's perspective in any proceedings, the entire liability for the harm assessed may rest on any gatekeeper individually or all gatekeepers collectively. As between the gatekeepers, though, where the regime includes a right of contribution, any gatekeeper that has paid to the plaintiff more than its share of liability, as measured by its contribution to the wrongdoing, may recount that excess from another liable gatekeeper or gatekeepers. Thus, where liability is ultimately apportioned among gatekeepers on a fixed share basis, the regime is equivalent to joint and several liabilities with a right of contribution; whether the plaintiff targets the gatekeepers jointly or severally, the right of contribution ensures liability is ultimately apportioned in fixed shares. Such a strict liability regime may not lead gatekeepers to take optimal precautions. This conclusion follows from the possibility that the gatekeepers may not cooperate but instead may act in isolation from each other in determining whether to take precautions in response to the risk of a particular wrong. The reasons for this are best illustrated with a basic numerical example. Assume that two gatekeepers—a law

firm and an accounting firm—contribute to the risk of a particular type of securities fraud, in the sense that both taking precautions optimally deter the fraud. Assume also that if the fraud occurs, it will produce social harm of 1000. Let us consider a strict liability rule that allocates liability equally between the two gatekeepers.

Where both gatekeepers take precautions, the total expected costs of wrongdoing—comprising the sum of the expected costs of wrongdoing and the costs of precautions—would be minimized, and thus optimal deterrence would be achieved. Even considering the costs of both gatekeepers exercising precautions (equal to 14), the total expected costs of securities fraud (equal to 94) would be minimized relative to the costs had only one or neither taken precautions. The question is whether this particular liability regime would induce the gatekeepers to act optimally by taking precautions. Consider the law firm's behaviour. If the accounting firm fails to take precautions, the law firm's liability would be 50 if it also fails to take precautions (representing 50% of the expected costs of corporate wrongdoing of 100) or 45 if it takes precautions (representing 50% of the expected costs of corporate wrongdoing of 90). However, if the accounting firm takes precautions, the law firm's liability would be 45 if it fails to take precautions (representing 50% of the expected costs of 90) or 40 if it also takes precautions (representing 50% of the expected costs of corporate wrongdoing of 80). Whether or not the accounting firm takes precautions, the law firm would reduce its liability by five. However, because the costs of precautions (8) exceed the expected benefits (5), the law firm would lack incentives to take precautions, despite it being socially desirable for the firm to do so.

The accounting firm would face parallel incentives. If the law firm takes precautions, the expected benefit to the accounting firm of taking precautions relative to not taking precautions would be 5 (representing its share of the costs of securities fraud being reduced from 45 to 40). Similarly, if the law firm fails to take precautions, the expected benefit to the accounting firm of taking precautions relative to not taking precautions would be 5 (representing its share of the costs of corporate wrongdoing being reduced from 50 to 45). Like the law firm, however, the accounting firm's costs of precautions (6) exceed the expected benefits from taking precautions (5), and therefore, like the law firm, the accounting firm would not take precautions. Because it fails to ensure that the gatekeepers would adopt precautions, this liability regime is not efficient. Altering the sharing of liability would not change the economic efficiency properties of the liability regime. For example, increasing the accounting firm's share of liability might lead it to take precautions, but it would leave the law firm with even less incentive to take precautions.

Extending the analysis to three or more gatekeepers also would not change the demonstrated inefficiency of this regime. For the intuition behind this, consider a transaction involving an accounting firm, a law firm, and an investment bank, in which all gatekeepers contribute to the risk of corporate wrongdoing. Consider the decision facing the law firm if the investment bank and accounting firm are taking precautions. If the law firm decides against taking precautions, it would be relieved of the cost of precautions and bear only a proportion (1/3 in this example) of the increase in the costs of the wrongdoing arising from it not taking precautions. If the costs of precautions exceed its share of the increase in liability, the gatekeeper will not take precautions.

This example shows why the analysis in the numerical example above is not contingent on the proportions in which the gatekeepers share liability or how many gatekeepers contribute to the risk of wrongdoing. Now consider a strict liability regime in which liability is apportioned jointly and severally but without a right of contribution (Liability Regime (ii) above). Under this regime, each gatekeeper would be held alternatively liable, at the plaintiff's option, for all or any part of the harm assessed. For similar reasons to those provided above, this regime may not lead gatekeepers to take precautions. Consider the same example in which an investment bank and accounting firm take precautions, and a law firm must decide whether to do so. The law firm would decide against taking precautions if the costs exceed the law firm's expected share of liability—an expectation that would depend on the likelihood of the law firm being the plaintiffs' chosen target. As before, this method of apportionment would not guarantee optimal behaviour by the law firm—or, indeed, by any gatekeeper facing that predicament—and thus would be undesirable.

2. Fault-based Liability

Let us now consider the desirability of fault-based liability regimes. Under these regimes, a gatekeeper would bear liability only where it fails to take adequate precautions and, correspondingly, is at fault or negligent. The discussion below assumes that the legal standard of care is set equal to the socially optimal level of care and corresponds to the taking of precautions. Consider first the fault-based regime under which liability is apportioned among negligent gatekeepers jointly and severally with rights of contribution (Liability Regime (iii)). Multiple gatekeepers would be led to take precautions. The explanation is apparent in light of two scenarios related to the numerical example above. First, either gatekeeper alone could act negligently by failing to take precautions and avoid the costs of precautions (either 6 or 8) but face a liability of 90. Second, both gatekeepers could act negligently by failing to take precautions and avoid the costs of

precautions, but each would face a liability of 50 (representing the total expected costs of corporate wrongdoing of 100 shared equally). As Professor Shavell recognizes in the analogous context of joint tortfeasors, neither of these alternatives can be equilibrium. Each gatekeeper in both scenarios would reason that, whatever the conduct of the other gatekeeper, it is better off taking precautions. Under this regime, a negligent actor would avoid the costs of precautions by failing to take care but would "bear the full brunt of liability" if it alone does not take precautions. Unlike under strict liability, the other gatekeeper will not be required to share liability where it takes precautions. Since social welfare is maximized when all the actors take precautions, the liability borne by the negligent gatekeeper must exceed the costs of precautions avoided. Thus, both gatekeepers would be led to act optimally under this regime by taking precautions.

Parallel incentives arise in scenarios involving more than two gatekeepers. It would not be rational for all gatekeepers to be negligent since, irrespective of how the costs of securities fraud were allocated among the gatekeepers, at least some would have to pay more than they would save by not taking precautions. It is because the aggregate costs of securities fraud exceed the aggregate costs of precautions. Regarding the same liability regime in the similar joint tortfeasor context, Professors Kornhauser and Revesz explain as follows: Any actors who had to pay more than their increased benefits would opt to be non-negligent. However, once those actors chose to be non-negligent, the apportionment rule would allocate damages exceeding their increased benefit to other actors. Regardless of how many actors are negligent, the increase in aggregate damage caused by that negligence would continue to be greater than the increase in the aggregate benefit. It would not be equilibrium for more than one gatekeeper to be negligent. Nor would it be equilibrium for one gatekeeper to be negligent since it would bear the full brunt of liability alone. Correspondingly, the regime creates incentives for all gatekeepers to take precautions. Consider now the same fault-based liability regime but without rights of contribution (Liability Regime (iv)). Where no rights of contribution exist, liability is apportioned according to the preferences of the plaintiff.

This regime is also efficient. A no-contribution regime is equivalent to a rule of contribution "in which an actor's share is her estimate the probability that she will be the one to be held jointly and severally liable and therefore responsible for the full damage." Such a regime thus shares the efficiency properties of a fault-based regime with joint and several liabilities and a right of contribution. Finally, let us consider a fault-based liability regime coupled with several (or non-joint) liabilities only for negligent gatekeepers (Liability Regime (v). In contrast to the joint and several liability frameworks, negligent gatekeepers would not face

liability for corporate wrongdoing attributed to non-negligent gatekeepers. They would face liability only for the contribution of negligent gatekeepers, and they would share that liability according to the predetermined basis of sharing. This regime may not be efficient, resulting from the fact that a negligent gatekeeper may face only a fraction of the liability for the securities fraud to which its negligence contributes. The fraction would depend on the method of sharing with other negligent gatekeepers. In the joint tort context, it has been established that whether several liabilities would lead actors to take optimal precautions depends on the benefit and damage functions and the number of actors. In short, a fault-based regime coupled with several liabilities may be inefficient, creating incentives for gatekeepers to act negligently.

C. Summary and Extensions

This Part has analysed the efficiency properties of the main liability regimes for independent and interdependent gatekeeper harms. The analysis showed that either strict or fault-based liability would lead the relevant gatekeeper to take optimal precautions for multiple independent gatekeepers. For multiple interdependent gatekeepers, the analysis showed the following. First, a regime of strict liability under which gatekeepers are jointly and severally liable may not lead gatekeepers to take precautions when it would be desirable for them to do so. This conclusion does not depend on whether rights of contribution exist or how liability is shared among liable gatekeepers. Second, a regime of fault-based liability under which gatekeepers are jointly and severally liable would be efficient, a conclusion that also stands whether or not rights of contribution exist. Finally, a fault-based regime under which gatekeepers are severally liable may not be efficient.

Importantly, gatekeepers have been assumed in the analysis thus far to be capable of bearing the entire liability imposed on them. Incentive problems will arise where this assumption is relaxed. Gatekeepers' incentives to take precautions are diluted, where they are protected from the total liability arising from their activities. In examining the properties of liability regimes for joint torts, and allowing for the potential insolvency of some of the actors, Professors Kornhauser and Revesz show that no general conclusion can be drawn, on efficiency grounds, as to which liability regime is the most desirable, casting doubt on the generality of the results above (Lewis A. Kornhauser & Richard L. Revesz,1990; William M. Landes (1990). The relative efficiency of regimes will depend on factors including, obviously, the particular solvency levels of the actors in question. Once the potential insolvency of an actor is introduced, inefficiencies may arise even under a fault-based regime with joint and several liabilities—the

regime shown above to lead gatekeepers to take precautions where doing so would be desirable.

A gatekeeper may be shielded from the full effects of a liability regime by an uncomplicated insufficiency of assets to satisfy the liability that arises from the harm the gatekeeper's activities contribute. The gatekeeper might also be shielded by a legal barrier, such as the principle of limited liability, which protects the assets of owners of incorporated entities from exposure to the corporation's liabilities. Nevertheless, the incentive problems associated with the shielding of liability should not be overstated. To begin, casual empiricism suggests that gatekeepers rarely become insolvent, with the collapse of Arthur Andersen being an obvious exception. The insolvency of the corporation (the gatekeepers' client) is a more common occurrence than the insolvency of gatekeepers and is the basi s upon which an analysis of gatekeeper liability typically proceeds. Furthermore, even though the personal assets of individuals associated with a gatekeeping firm may be protected from exposure to creditors of the firm under the firm's incorporation, individuals' interests will often be closely aligned with those of the firm since a substantial portion of their wealth—indeed, often their livelihood—is tied up in it.

A further factor to consider is the risk of legal error. Even under an efficient liability regime, gatekeepers take optimal precautions, and gatekeepers may be found liable. This result may arise from legal error by a court, inadvertence by gatekeepers, or agency problems within gatekeeping firms. Where legal error exists, the presence of multiple gatekeepers and the consequent sharing of liability would dilute the incentives of gatekeepers individually to take care, relative to scenarios involving a unitary gatekeeper. One response to the problem of inadequate incentives is to require firms to purchase liability insurance, which may counteract the dilution of incentives caused by asset insufficiency. It may also prompt gatekeepers to take more care where insurers can determine the gatekeepers' levels of precautions and link the insurance premium, or other policy terms, to the gatekeepers' precautions. Where insurers cannot do this, gatekeepers' incentives may be further diluted because of the insurance coverage.181 another response is to hold principals of a gatekeeping firm personally liable where the gatekeeping firm cannot meet its debts. A further response is to discipline individuals at gatekeeping firms. Professional self-regulatory organizations might perform such a role. In sum, incentive problems associated with asset insufficiency of gatekeepers may well arise, and various techniques exist for attempting to solve them.

The Concept of Gatekeeper Liability

The analysis above casts fresh doubt on the suitability of strict liability for gatekeepers, at least in contexts characterized by multiple gatekeeper involvement. A prominent scholarly view, however, endorses the application of strict liability to gatekeepers. As Assaf Hamdani, a critic of this view, explains, proponents of strict liability point to the advantages of that standard of liability over fault-based liability. However, crucially, these scholars are operating in a unitary gatekeeper world, assuming that a single gatekeeper acts on a business transaction or that, where multiple gatekeepers are involved, gatekeepers are independently capable of deterring securities fraud. The analysis in this article has shown that such a unitary conception of gatekeepers is unlikely to reflect reality accurately or provide a firm basis for policy prescription. As this analysis has illustrated, for multiple interdependent gatekeepers, strict liability would not necessarily lead gatekeepers to take precautions to deter securities fraud where doing so would be socially desirable.

A related implication of the analysis in this Article concerns the conception of gatekeeper liability as a form of vicarious liability. Under vicarious liability, the wrong of an agent is imputed to its principal, with the principal and agent facing liability jointly and severally. In a sense, the principal is strictly liable for its agent's wrong because liability attaches to the principal without any requirement that the principal is at fault. Under optimal deterrence theory, however, this article has demonstrated that gatekeeper liability may also be conceived of as direct liability, with gatekeepers facing liability directly because of the precautions they take to exercise their power to monitor and control corporate conduct. Conceiving gatekeeper liability as a vicarious liability in the context of business transactions also overlooks the inevitability that gatekeepers already face some measure of deterrence by the vulnerability of their reputations to damage. It follows from this that holding gatekeepers vicariously liable for securities fraud perpetrated by their clients would lead to over-deterrence. It may also lead to the unravelling of gatekeeping markets, as Professor Hamdani has shown for strict liability.

Risk-shifting Among Gatekeepers

Turning now to consider the interactions among multiple gatekeepers in more detail, the question arises as to why gatekeepers would not bargain among themselves to apportion liability efficiently. This question is especially pertinent considering that the underwriter is identified as the prime target of liability under Section 11, yet multiple gatekeepers may contribute the wrongs. According to the Coase Theorem, voluntarily bargaining parties in a world without transaction costs will reach a mutually beneficial—and thus, efficient—an agreement where

the opportunity exists for them to do so, provided legal rights are well-defined. While the Theorem was initially formulated in parties bargaining over property rights, its claim applies in the current context. A study of gatekeeper practices in securities transactions reveals that gatekeepers bargain among themselves to apportion liability arising from disclosure wrongs. In response to potential liability under Section 11, underwriters routinely adopt risk-shifting arrangements with other gatekeepers, namely accountants and lawyers. As a condition precedent to underwriting a proposed securities offering, underwriters will receive "comfort letters," which are also often referred to as "negative assurance letters," from other gatekeepers attesting to the accuracy of various parts of the registration statement. These arrangements are directed to non-expertise portions of registration statements since Section 11 imposes liability solely on the underwriter, irrespective of which gatekeeper or gatekeepers contribute to the wrong in question, whereas the (non-underwriter) gatekeeper that authorizes an expertise portion of the registration statement is the prime target of liability for wrongs in those portions.

The risk-shifting framework is depicted graphically below. The corporation's law firm will provide an adverse assurance letter (the linguistic terms of which track Rule 10b-5) attesting that the law firm or relevant individual lawyers are unaware of any material misstatements or omissions in the registration statement. The accounting firm, similarly, will provide to underwriters a comfort letter giving assurance concerning a wide array of financial information throughout the registration statement, including information disclosed in the text, charts, and graphs— information that is separate from the audited financial statements, which are expertise portions of a registration statement.

These risk-shifting arrangements are intended to serve dual purposes. Primarily, the arrangements are designed to apportion liability. They create devices "by which [the underwriters] can recover on a theory of negligent or fraudulent preparation of the [negative assurance or] comfort letter for any liability the underwriters incur to investors, provided sued-upon misrepresentations were also the subject of [such] a . . . letter [Restatement (Third) of the Law Governing Lawyers (2000)]." It would be optimal for these arrangements to allocate liability so that any gatekeeper contributing to a wrong— and not simply the underwriter— would face potential liability and thus have incentives to take precautions to exercise its power to monitor and control the corporation's conduct. More specifically, where multiple gatekeepers contribute to a particular wrong (in the sense that optimally deterring the wrong would require those gatekeepers to take precautions), it would be desirable for the liability regime to lead those gatekeepers to take precautions. Arrangements

among gatekeepers are designed to achieve this outcome rather than to leave the underwriter as the sole bearer of liability. The second and related purpose of these risk-shifting arrangements is to buttress the underwriters' due diligence defence. In determining whether the defence is established, the underwriters' "receipt of [a] comfort letter will be important evidence but is insufficient by itself to establish the defence," mainly where red flags exist.

Assessment

The multiple gatekeeper analysis gains the most traction when considering gatekeepers' liability for non-expertise portions of the registration statement. In terms of optimal deterrence theory, the selection of underwriters as the first (and only) line of defence might reflect Congress's intuition that underwriters are either the "cheapest cost avoiders"— and therefore able most effectively among all gatekeepers to reduce the costs of securities fraud—or, to use another Calabresian notion, the "best bribers"—the actors that can most cheaply identify and enter into arrangements with other gatekeepers in order to reduce the costs of securities fraud. Given the securities offering process dynamics, including the likelihood that optimal deterrence will require precautions to be taken by multiple gatekeepers, the "best briber" explanation is the more plausible interpretation. Correspondingly, the Section 11 approach of making underwriters the sole target of liability appears to reflect a nuanced congressional attempt to deal with the possibility that multiple gatekeepers may optimally deter disclosure wrongs. The elaborate risk-shifting framework described above represents a market response to that approach.

The framework may well fail in its apparent mission. The first problem concerns the risk-shifting arrangements among gatekeepers, which appear not to reflect the forces of free bargaining. First, the assurances given to underwriters are carefully framed within the guidance offered by professional regulatory bodies. The assurances are often extraordinarily narrow. Both the American Bar Association (ABA) and the American Institute of Certified Practicing Accountants (AICPA) have issued guidance to their practitioners as to the terms of their letters [ABA Negative Assurance Report (1995)]. In its guidance, the ABA asserts that a "lawyer is not an insurer of the adequacy of the disclosure in an offering document or a 'reputational intermediary." It then describes with approval the following customary qualifications in letters by lawyers: Virtually all negative assurance letters state that counsel does not assume any responsibility for the accuracy, completeness, or fairness of the offering document, except to the extent that specific sections are addressed in a separate opinion or confirmation. Some letters refer to limitations on counsel's professional engagement and the

fact that many of the disclosures in an offering document are non-legal. Some state that counsel is relying on the judgment of management or others regarding the adequacy of disclosure. Many [letters] state that counsel has not undertaken to verify the facts contained in the disclosure document.

Compelling Cooperation Among Gatekeepers

One practical challenge this Article presents is operationalising its analysis by identifying scenarios calling for precautions being exercised by multiple gatekeepers. Put differently, what wrongs are optimally deterred by the exercise of precautions by multiple gatekeepers? Once these scenarios are identified, one could compel cooperation to alleviate problems associated with the fragmentation of gatekeeping services. Cooperation in this sense would involve gatekeepers sharing information and expertise to settle particular disclosure questions. The approach would promise to overcome, and thereby discourage, the practices of some clients or gatekeepers of failing to consult with other gatekeepers on some questions and of clients interposing themselves between gatekeepers. The approach would also promise to overcome the rigid separation of functions among various gatekeepers that may produce gaps in oversight as well as gatekeeper attempts to adopt a "head-in-the-sand approach" to avoid having to say "no" to a client [Herbert Smith, Hong Kong IPO Guide 18 (2006)].

One model approach adopted in the United Kingdom and other British Commonwealth jurisdictions is the practice of formal verification meetings for securities offerings, in which the various gatekeepers meet to substantiate the contents of the offering document. So rigorous and detailed is the process that a comprehensive report is often produced that substantiates each material statement of fact in the offering document by referencing independently written material. Multiple gatekeepers will attend to ensure that their collective expertise and knowledge is brought to bear on disclosure issues. The novelty of the approach is that it requires multiple gatekeepers not simply to exercise precautions but to cooperate in doing so. It also diminishes the extent to which gatekeepers may plausibly deny knowledge of information. Such precautions might be expected to deter that form of misconduct susceptible only to the expertise of multiple, specialized actors cooperating to connect the various dots that will reveal fraud.

Verification meetings have their genesis in domestic U.K. offerings. Nevertheless, practices in the U.K., especially for significant transactions, have evolved with the increasing influence in Europe of U.S.- headquartered investment banks, which underwrite major securities offerings. One result has been adopting U.S. due diligence practices in the United Kingdom in securities transactions by corporations seeking to raise funds internationally, including from

U.S. institutional investors [Howell E. Jackson & Eric J. Pan, (2008)]. A significant feature of this trend is the resistance of U.S. investment bankers, familiar with U.S. due diligence practices, to prepare written verification reports for fear that the reports may include "smoking guns" that might be seized upon by plaintiff lawyers in any litigation. The approach of other British Commonwealth jurisdictions, particularly Australia and Singapore, which have been less influenced by U.S. practices, may be more instructive and focus on the discussion below.

Several features of the verification process deserve elaboration. The first is its integrated nature. Multiple advisers, including underwriters, accountants, and lawyers, meet with representatives of the issuer to pool their expertise and knowledge [Institute of Certified Public Accountants of Singapore, Proposed Audit Guidance Statement on Comfort Letters and Other Assistance for Public Offerings of Equity Securities in Singapore 17–18 (2008); Ian M. Ramsay & Baljit K. Sidhu, (1995); Greg Golding (Dec. 31, 2001)]. In Australia, for example, representatives of the issuer and its various advisers form a committee, referred to as the Due Diligence Committee, which formally delegates the verification of particular aspects of the offering document to individual advisers, charging them with responsibility for reporting back to the committee. The committee is responsible for coordinating and overseeing the due diligence process. In Singapore, auditors often participate in verification meetings without the presence of corporate management, perhaps allowing them to speak more openly regarding disclosure issues than they otherwise might.

A second feature concerns the lack of duplication of due diligence. For example, rarely will an underwriter's law firm duplicate the due diligence of the issuer's law firm, as typically occurs in U.S. securities offerings. Instead, for matters in which lawyers are considered to possess suitable expertise, the committee will task the issuer's lawyers with reporting the findings of its due diligence to the committee, which as a body—drawing on the expertise and information of its various members— will determine whether to probe further into various matters as it assesses the accuracy of the offering document. The committee will identify critical issues for investigation, review reports provided to it, and determine what disclosure response is required. Although information and expertise is inevitably pooled, the general approach is for each adviser on the committee to rely without independent verification on the information or advice for which another adviser on the committee has been delegated responsibility [Accounting Professional & Ethical Standards Board, (2009)].

A further feature of the verification process is preparing a written report, which will be provided to the corporate issuer's board of directors. The committee

will prepare a verification report to verify material statements of fact and opinion in the offering document in Australia. It will also prepare a key issues report, which details the critical disclosure issues and how they were dealt with, by disclosure or otherwise. The committee will thus coordinate its efforts with the drafting of the offering document. In sum, the verification process involves the pooling of information and expertise, minimal duplication of due diligence, and producing a written report attesting to the accuracy of the relevant offering document.

Formal verification meetings are not a part of securities law practice in the United States. No due diligence report is prepared for securities offerings, and no formal meeting is held at which the numerous gatekeepers simultaneously attempt to verify material statements in the offering document. However, the practice has the distinct advantage of marshalling the various talents of gatekeepers and bringing them to bear on disclosure issues, and perhaps also of dulling incentives that a knowledge-based standard of liability creates to have only a fragmented knowledge of a corporation's activities. Still, the process is expensive, and the issue arises as to whether it would be worth its cost. The production of a report is anathema to U.S. securities law practice. One compromise, though, that would capture many of the benefits and avoid much of the cost would require gatekeepers to meet to discuss any particularly vexing disclosure issues, possibly even in the absence of management. Examples of such issues would include how to disclose the reasons for the departure of a CEO and how to describe the extent of expected losses of a business being acquired. Not every material statement need to be verified. However, any susceptible statements would be discussed to share expertise and knowledge, to the extent that doing so is considered to reduce the risk of securities fraud at an acceptable cost. Carefully framing the terms of such a requirement would be crucial—and the proposal is simply suggested here as food for thought. An alternative proposal in a similar vein would be to permit, or even to require, a gatekeeper not simply to "report up" potential wrongdoing to a corporate client's general counsel or audit committee but to "report across" to other gatekeepers that have the expertise or other characteristics suited to assessing and deterring potential corporate wrongdoing.

Section VII: The Bangladesh Scenario

Appointment of Board of Directors: Upon appointment, the new director should be issued a letter of appointment, written and signed by the Chairman. Such letter would set out the terms of his/her appointment and include: Provision of Directors' Liability insurance and professional indemnity; Access to independent professional advice; Committees; Details regarding any formal

process of induction so that he/she is well informed about the operations of the company; Details regarding on-going directors' training and development; and Policy and process of appointing alternates (if permitted); Term of office; The remuneration and benefits if any; Duties and responsibilities; Expected workload and time commitment; How the appointment can be terminated; Obligation to comply with any Board decisions; Confidentiality policy; Conflict of interests policy; and Review processes.

How board evaluations can help prevent Corporate Failures

The pressure to perform: Averting corporate failure is not the only pressure faced by boards. Increasing demands for organizational performance are also increasing performance pressures on boards. Boards are held increasingly accountable for corporate performance. It represents a paradigm shift in management thinking, and the full implications are just dawning upon companies and commentators alike (Pound, 1995). There has been a dramatic rise in shareholder activism over the past two decades. Increased activism increases the power of large institutional investors, who are becoming far more demanding of boards—increasing media and community scrutiny of all aspects of corporate life. Public scrutiny will continue and only intensify community expectations that boards need to be brought to account for the performance of the companies they govern. Governance Failure results in Corporate Scandals, which negatively impact the GDP—reasons behind governance failures: Strategic failure; Control failure; Ethical failure; and Interpersonal relationship failure.

Power and trust in Board–CEO relationships: Ideal Situation

Board power: The board has considerable insights and knowledge, considerable experience from other firms, considerable industrial experience and expertise Finkelstein's suggestion [(1992); Hillman and Dalziel (2003)]. Measuring power from four manifestations: ownership, structure, expertise and prestige. Board trust: board members accept and admit risks for potential mistakes in their evaluations. The board is willing to advise the CEO based on their knowledge, views and ideas. The board openly supplies the management relevant advice based on personal references and evaluations [Butler 1991; Davis et al. 2000, Mayer et al. 1995; Whitener et al. 1998; Gillespie 2003); Gillespie 2003; Van Ees et al. (2009b). *Relational risks:* The CEO would instead seek advice from the board rather than from external consultancies. All board directors actively participate in discussions in board meetings. Board directors are always available to perform tasks whenever managerial need emerges. Board directors are always well prepared for board meetings. Board service tasks: Board advises CEOs on

Name	Core Function	Admin Ministry	Department	Dependent/ Independent	Kind of Gatekeeping	Non-Capital Market (NCM)	Capital Market (CM)	Response To PAC	Response To PUC
Parliamentary Committee on Public Accounts	For monitoring and supervision, each ministry is accountable to this Standing Committee	All	All Public Sector Entities	Independent		√	√	Parliament	
Parliamentary Committee on Public Undertakings	For monitoring and supervision, each PU is accountable to this Standing Committee	All	All Public Sector Entities	Independent		√	√		Parliament
Registrar of Joint Stock Companies	Regulation & Governance of all registered Companies	Ministry of Commerce	Company wing of MoC	Independent	Regulatory	√	√	PAC	PUC
Bangladesh Bank	Regulation and Governance	Ministry of Finance & Banking	Banking wing and BRPD	Independent	Regulatory	√	√		
Securities & Exchange Commission	Regulation & Governance of all Listed securities and Bonds	Ministry of Finance & Banking	Ministry of Finance	Independent	Regulatory	√	√	PAC	PUC
Insurance Regulatory and Dev Authority	Regulation of all Insurance Cos	Ministry of Finance & Banking	Ministry Finance Insurance co Desk	Independent	Regulatory	√	√		
Stock Exchanges	Regulation of all listed securities and bonds	Ministry of Finance & Banking	Ministry of Finance & SEC, IDRA	Dependent	Regulatory		√	PAC	PUC
Institute of CA Bangladesh	Regulation of Auditing and Financial Reporting	Ministry of Commerce	Ministry of Commerce Professional Institutes	Independent	Regulatory Auditing, Reporting and Disciplining members	IFAC, IASB, SAFA, CAPA √	√	PAC	PUC
Institute CMA Bangladesh	Regulation of Cost Audit	Ministry of Commerce	Ministry of Commerce Professional Institutes	Independent	Cost Auditing, Reporting & Disciplining members	√ IFAC, IASB, SAFA, CAPA	√	PAC	PUC
Credit Rating Agencies	Credit Rating	Finance Ministry	SEC, Bangladesh Bank	Independent	Rating Report	IOSCO		PAC	PUC

Continue

Name	Core Function	Admin Ministry	Department	Dependent/ Independent	Kind of Gatekeeping	Non-Capital Market (NCM)	Capital Market (CM)	Response To PAC	Response To PUC
Auditing Firms	Auditing and Certifying Financial Report	ICA Bangladesh		Independent	Certifying the Audit Reports	√	√	PAC	PUC
IPO Managers			Stock Exchanges, SEC, IDRA, BERC	Independent	Certification of future projection	√	√	PAC	PUC
Valuation Firms	Valuation Report		SEC, IDRA, BERC, Stock Exchanges,	Independent	Valuation certificate	√	√	PAC	PUC
Financial Analysts	Analytical Reports	Regulators, Journalists of Print and Electronic Media	SEC, IDRA, BERC, Stock Exchanges,	Independent		√	√	PAC	PUC
Company Directors	Company Policy and Operational decision in line with relevant comm. Codes and Company AA &MA	To all regulators of capital market and comm. Codes, Public interest groups, shareholders and all stakeholders	SEC, IDRA, BERC, RJSC, Stock Exchanges, Lending Institutions, Merchant Bankers, Stock Brokerage Firms	Dependent	All signed reports, information and figures presented in the report, statements made to the press and media and the regulators	√	√	PAC	PUC
Company Secretary	Company Policy and Operational decision in line with relevant comm. Codes and Company AA &MA	To all regulators of capital market and comm. Codes, Public interest groups, shareholders and all stakeholders	SEC, IDRA, BERC, RJSC, Stock Exchanges, Lending Institutions, Merchant Bankers, Stock Brokerage Firms	Dependent	All signed reports, information and figures presented in the report, statements made to the press and media and the regulators	√	√	PAC	PUC

Continue

Name	Core Function	Admin Ministry	Department	Dependent/ Independent	Kind of Gatekeeping	Non-Capital Market (NCM)	Capital Market (CM)	Response To PAC	Response To PUC
Chief Legal Officer	Company Policy and Operational decision in line with relevant comm. Codes and Company AA &MA	To all regulators of capital market and comm. Codes, Public interest groups, shareholders and all stakeholders	SEC, IDRA, BERC, RJSC, Stock Exchanges, Lending Institutions, Merchant Bankers,	Dependent	All signed reports, information and reported figures statements made to press and media and the regulators	√	√	PAC	PUC
Chief Financial Officer	Company Policy and Operational decision in line with relevant comm. Codes and Company AA &MA	To all regulators of capital market and comm. Codes, Public interest groups, shareholders and all stakeholders	SEC, IDRA, BERC, RJSC, Stock Exchanges, Lending Institutions, Merchant Bankers, Stock Brokerage Firms	Dependent	All signed reports, information and figures presented in the report, statements made to the press and media and the regulators	√	√	PAC	PUC
Chief Compliance Officer	Company Policy and Operational decision in line with relevant comm. Codes and Company AA &MA	To all regulators of capital market and comm. Codes, Public interest groups, shareholders and all stakeholders	SEC, IDRA, BERC, RJSC, Stock Exchanges, Lending Institutions, Merchant Bankers, Stock Brokerage Firms	Dependent	All signed reports, information and figures presented in the report, statements made to the press and media and the regulators	√	√	PAC	PUC
Corporate Legal Counsel	Company Policy and Operational decision in line with relevant comm. Codes and Company AA &MA	To all regulators of capital market and comm. Codes, Public interest groups, shareholders and all stakeholders	SEC, IDRA, BERC, RJSC, Stock Exchanges, Lending Institutions, Merchant Bankers, Stock Brokerage Firms	Independent	All signed reports, information and figures presented in the report, statements made to the press and media and the regulators	√	√	PAC	PUC

Continue

Name	Core Function	Admin Ministry	Department	Dependent/ Independent	Kind of Gatekeeping	Non-Capital Market (NCM)	Capital Market (CM)	Response To PAC	Response To PUC
Bangladesh Energy Regulatory Commission	Regulation of Energy and Electricity Companies	Energy, Power, and Mineral Resources	Energy, Power, and Mineral Resources	Dependent	Licensing, Regulating, Pricing and Reporting	√	√	PAC	PUC
Bangladesh Telecom Regulatory Commission	Regulation of Telco Operators	Ministry of Post and Teleco	Teleco Division	Dependent	Protecting public interest in terms of pricing and quality of services	√	√	PAC	PUC
Bangladesh Road Transport Authority	Construction Maint of Road & Bridges	Ministry of Road and Bridges	Road and Bridge Division	Dependent	Quality Assurance of Constructions, Driving License	√	-	PAC	PUC
Airport Dev Authority	Regulation and construction of Air Ports	Ministry of Civil Aviation & Tourism	Aviation Industry Division	Dependent	Quality Assurance of Industry Services and Pricing of Tickets	√	-	PAC	PUC
Bangladesh Inland Water Transport Authority	Regulating and Developing Inland Water Transport	Ministry of Inland Water Transport	Transport Division	Dependent	Regulation and Quality Assurance of Services and pricings	√	-	PAC	PUC
Director-General Drug Admin	Licensing, Regulation, Pricing, QA, GMP	Ministry of Health & Family Welfare	Drug Admin Division	Dependent	Licensing, QA, Pricing, Supervision of Procurement, Disciplining Manuf. Process	√	-	PAC	PUC

Board of Directors as Corporate Gatekeeper-Bangladesh

Skills of the Board: Topics and Sample Questions		Bangladesh
Topic	Sample Questions	
Defining governance roles	Is the role of a board member clearly defined?	No
	Is the role of a board member well understood	No
	Does the spread of talent within the board reflect the company's needs?	No
	Do all board members bring valuable skills and experience to the company?	No
	Is the board large enough to carry out the work required of it?	No
Improving Board Process		
Board meetings	Do the board papers contain the correct amount and type of information?	No
	Are board members diligent in preparing for meetings?	No
	Are matters relating to the company discussed in a structured manner?	No
Key Board Functions		
Strategy	Does the board know and understand the company's mission, vision and strategy?	No
	Does the board know and keep abreast of trends and issues affecting the company's market competencies?	No
	Does the board understand the business it is governing?	No
Service/advice/contacts	Do board members actively engage in networking for the benefit of the company?	
Service/advice/contacts		
Monitoring	Do board members have sufficient financial skills to ensure the board can discharge its governance responsibilities?	No
Compliance	Does the company have relevant internal reporting and compliance systems?	No
Risk management	Are board members aware of their risk assessment duties as directors?	No
	Is there a clear understanding of the company's business risk?	
Continuing improvement		
Director development	Does the board encourage directors to pursue opportunities for personal development?	No
Director selection and induction	Does the board have a succession plan in place for the chairperson?	No
	Does the board have a director succession plan in place?	No
	Are there clear and well-understood policies and procedures in place for director selection and induction?	No

Evaluating Board of Directors

Chairperson	Non-executive director	Committee
Advantage	Advantage	Advantage
Part of leadership role – explicit acceptance by board members.	Clear accountability.	Relieves chairperson/ non-executive director of Workload.
Clear Accountability.	More independent view.	Less reliant on the viewpoint of one person.
Can align the process with the overall board agenda.	More time to devote to the task. Other leadership experiences/ skills.	Less subject to individual bias.
Disadvantage	Disadvantage	Disadvantage
Possible bias.	Possible bias.	Longer Process.
Concentration of power, particularly if the CEO is Chairperson.	Possible effect on board Dynamics.	Demands more excellent resources (time, money)
Heavy workload.	Knowledge of the company will be less than that of the Chairperson.	

Skills Experiences and Attributes Metrics of Members of Board of Directors

Skills	Experiences	Attributes
Practical wisdom and good judgment	Specialist knowledge in a specific area	Highest personal and professional, ethical standards and honesty
Financial literacy; ability to read and understand a financial statement	Detailed knowledge of the industry / relevant industry experience	Integrity, independence and free of conflicts of interest
Specialized professional skills: Accounting, Finance, HR, Legal, ICT, Marketing	Expertise in global issues	An enquiring and independent mind
An understanding of key technologies	Experience in other industries using experience gained in one industry for the benefit of a company in another industry	Willingness and commitment to devote the required amount of time to carry out the duties and responsibilities of Board membership, including time to gain knowledge of the industry, prepare for Board meetings and participate in Committees.
Director education – a clear understanding of the duties of a director and knowledge of the Code.	High visibility in the field	Commitment to improving the business, its continued well-being and making a difference. Commitment to making this role a significant priority, not serving just for the money or personal interests.
Good interpersonal skills and the ability to communicate clearly	Leadership and management experience, especially in related businesses	Willingness to represent the best interests of all stakeholders and objectively appraise board and management performance
Decision-maker – exploring options and choosing those that have the greatest benefit to the organisation and its performance	International experience	Critical analysis and judgment
Risk Management	Personal networks and external Contacts	Vision, imagination and foresight
Interpersonal sensitivity – a willingness to keep an open mind and recognise other perspectives		Strategic perspective, able to identify opportunities and threats
Ability to mentor other directors		Innovator - a willingness to challenge management and challenge assumptions, stimulate board discussion with new, alternative insights and ideas
Strong ability to represent the company to stakeholders		Curiosity - possessing an intellectual curiosity about the company and the trends impacting it
Agility to move from advisor to challenger as well as being a robust supporting voice when needed		Motivation – drive and energy to set and achieve clear objectives and make an impact
Advisory skills		Conscientiousness - clear personal commitment
		Engagement- full participation and proactive as a Board member
		Courage - willingness to deal with challenging issues
		Maturity and discipline to know and maintain the fine line between governance and managerial oversight

Evaluating Corporate Boards and Directors

Who has the knowledge			
Category	Information sources	Knowledge benefits	Potential drawbacks
Internal Sources	Board members	Should have critical knowledge on skills, processes, relationships, level of shared understanding	Suffer from biases (such as groupthink). Little understanding of external perceptions of the board. Do not provide a "set of fresh eyes" with which to examine governance processes.
	Chief Executive Officer	Should have a different perspective on all elements of board activity. Critical insight into the advice role of the board. Essential insight into succession issues.	Potentially suffers from biases. Potentially impression manages for the board, particularly on issues of management activities. May have a limited or biased understanding of external Perceptions.
	Senior managers	Generally good insights into communication between the board and management	May not have enough exposure to the Board. Internal company Politics may taint it.
	Other employees	Should have insight into the culture of the organization. The further removed from the board, the less likely employees can comment on actual performance.	Limited exposure to the board
External sources	Owners/members	Understand ownership aims	It will depend on the ownership structure (maybe disparate)
	Customers	Can have unique insights, particularly if the company has very few customers	Most likely will have little insight into how the board operates. Most likely will have little insight into how the board operates.
	Government	Can have insightful views, particularly in certain areas of compliance, if these are critical	Often limited interaction with most companies
	Suppliers	Can have unique insights, particularly if the company has very few suppliers	Most likely will have little insight into how the board operates
	External experts	Proper benchmarking or best practice insights	May not understand company's context
	Other stakeholders	Will depend on the nature of the company	Will depend on the nature of the company

issues related to legal and accounting. Board advises CEOs on issues related to finance Board advises CEOs on issues related to production and technologies. Board advises CEOs on issues related to marketing. Four items are used. They measure board activities related to advising the CEO in functional areas such as legal and accounting, finance, production, technology and marketing. Board control tasks: Board evaluates and controls issues related to budgeting Board evaluates and controls issues related to capital investment Board evaluates and

Potential Benefits of Board Evaluation

Benefits	To organization	To the board	To Individual directors
Leadership	Sets the performance tone and culture of the organization. Role model for CEO and senior management team.	An effective chairperson utilizing a board evaluation demonstrates leadership to the rest of the board Demonstrates long-term focus of the board Leadership behaviours agreed and encouraged	Demonstrates commitment to improvement at an individual level
Role clarity	Enables clear distinction between the roles of the CEO, management and the board. Enables appropriate delegation principles.	Clarifies director and committee roles. Sets a board norm for roles	Clarifies duties of individual directors. Clarifies protection of directors. Clarifies expectations
Teamwork	Builds board/CEO/ management relationships	Builds trust between board members. Encourages active participation. Develops commitment and a sense of ownership. Focuses board attention on duties to stakeholders.	Encourages individual director involvement. Develops commitment and a sense of ownership. Clarifies expectations
Accountability	Improved stakeholder relationships, e.g. investors, financial markets Improved corporate governance standards. Clarifies delegations. Clarifying strategic focus and corporate goals	Ensures board is appropriately monitoring organization	Ensures directors understand their legal duties and responsibilities. Sets performance expectations for individual members.
Decision making	Improves organizational decision making	Clarifying strategic focus. Aids in the identification of skills gaps on the board Improves the board's ability.	Identifies areas where director skills need development. Identifies areas where the director's skills can be better utilised.
Communication	Improved board–CEO Relationships Improves board–management Relationships. Improves stakeholder relationships. Improves stakeholder Relationships	Improves board–management relationships. Builds trust between board members.	Builds personal relationships between individual directors.
Board operation	Ensures an appropriate top-level policy framework exists to guide the organization.	More efficient meetings Better time management	Saves directors' time. Increases effectiveness of individual contributors. Save directors time. Increase effectiveness of individual contribution

Adopted Kiel, G. C., Nicholson, G. J. and Barclay, M. A. (2005) *Board, Director and CEO Evaluation. Sydney:* McGraw-Hill

Moody's Summary Views on Key Corporate Governance Issues

Issue Area	Moody's View
Board Composition and Independence	In our view, both shareholders and creditors benefit from robust board oversight of senior management, adequate independence, and appropriate skills and backgrounds of board members.
Board Leadership	We view that the presence of an independent chair or independent lead director with substantive responsibilities improves board effectiveness.
Ownership and Control Issues	Much depends on context. We tend to have more comfort with widely held firms subject to complete disclosure requirements. Controlled companies present a unique analytical challenge. Controlling owners can operate with a long-term view, in alignment with creditors' interests. However, controlling ownership can have several risks, including the potential for conflicts of interest and abusive related-party transactions.
Takeover Defences	Mixed views, and much depends on context. On the one hand, they may focus on corporate management in the long term and therefore promote alignment with creditors' interests, but they can also entrench management.
Management Quality	Depth and experience of senior management and robust succession-planning processes are areas of particular focus.
Executive Compensation	We are primarily concerned with pay structures and metrics that focus on long-term sustainable performance and alignment with creditors' interests. Shareholders' and creditors' interests in this area may differ.
Internal Controls, Compliance, and Risk Management	A well-functioning and profoundly embedded system of controls and internal checks and balances reduce operational risk and a company' overall risk profile. Effective risk management is a key credit concern.
Shareholder Activism	The more aggressive variety of activism (i.e. by activist hedge funds is primarily negative for creditors since activists may agitate for strategic, financial, and policy changes that may benefit shareholders at creditors' expense. However, there have been cases where activism has led to positive outcomes for creditors.

Adopted: Corporate governance: perspectives from a credit rating agency Consulting editors Steven A. Rosenblum, Karessa L. Cain, and Sabastian V. Niles, Wachtell, Lipton, Rosen & Katz (2014) *NYSE: Corporate Governance Guide* © December

controls issues related to company liquidity situation Board evaluates and controls issues related to risk management four items. They cover board control activities in budget evaluation, capital investment decisions, company liquidity situations, and risk management.

If any state-owned entity, the listed entity in the stock market, privately owned entities, banks and financial institutions follow the above practices, which are required to be supervised by the designated gatekeeper applying the due diligence approach correctly on a time interval and take appropriate action to the wrongdoers the corporate scandals would be reduced. It would help identify the problems with the creation of gatekeeping scandals and punish them, and the others engaged to do more will be restrained.

Section VIII: Summary, Conclusion and Recommendations

Corporate Gatekeepers are intermediaries who provide verification and certification services to investors by pledging their professional reputations—and, by withholding such support, block admission through the gate (Erik F. Gerding, 2006). Law's gatekeeper approach always imposes a monitoring duty but not necessarily a reporting duty: eventual discovery exposes the gatekeeper to liability for the primary violation, not merely a remedy for non-reporting. Even so, the gatekeeper approach is intended to give professionals regulatory incentives to prevent misreporting. Most gatekeepers are paid for their services by the enterprises that retain them; all have stated duties whose breach exposes them to legal liability. Gatekeepers include auditors and attorneys, who work directly with and essentially inside the enterprise. Lawyers advise on transaction design and disclosure. Duties of both auditors and lawyers arise initially from the contract but include a regulatory overlay of professional standards. Gatekeepers also include other transaction participants, such as investment banks and sometimes rating agencies, plus professionals working apart from transactions outside the enterprise, such as securities analysts and possibly stock exchanges and mutual funds. Coffee's list of gatekeepers are auditors, credit rating agencies, securities analysts, investment bankers, and securities lawyers. Known as gatekeeper liability, the liability of professionals for the wrongs of their clients is premised on the ability of professionals to monitor and control their clients' conduct. The imposition of potential liability provides powerful incentives for professionals to exercise their ability to monitor and control, thereby deterring corporate wrongs. Corporate Scandals of the 21st Century: limitations of mainstream corporate governance literature and the need for a new behavioural approach.

Adverse Economic impact of Corporate Scandals resulting from the failure of Corporate Gatekeeping

The number of corporate scandals associated with corporate governance problems in the first decade of this century is extensive. Wikipedia website, for instance, provides a list of more than 75 corporate scandals throughout this period. Their economic relevance is enormous. Table 1 lists 23 selected high profile corporate scandals that, together, have destroyed an estimated US$750 billion of their shareholders' equity. The initial argument is that governance scandals are the direct outcome of a standard set of fourteen interrelated factors detailed ahead, such as excessive concentration of power, ineffective board of directors, the passivity of investors, failure of gatekeepers, poor regulation, lack of the proper ethical tone at the top. Conflicts of interest afflicting gatekeepers, and the

corresponding lack of independence, can impair a gatekeeper's reputation and the quality of its certification as to the accuracy of a corporation's disclosures.

Potentially troubling product of the multiple gatekeeper phenomenon is the opportunity it creates for clients to disaggregate their work among multiple gatekeepers for the purpose of minimizing the ability of any individual gatekeeper to deter securities fraud. The adverse effects of such a practice could be exacerbated if the client also interposes itself between the various gatekeepers, rather than allowing them to interact with each other directly. Collective blame for recent business failures has fallen on gatekeepers. The conventional view is that auditors, lawyers, underwriters, analysts, and others have shirked their responsibilities and permitted illegal conduct. For this reason, doubt exists as to whether, if the existing legal barriers were removed, multidisciplinary firms would evolve and be relied upon by corporations undertaking business transactions.

Comparative Gate Keeping in the Developed Market Economies

The gatekeepers most heavily regulated by statute are directors. The current Canadian gatekeeper liability regime for directors is in line with the U.S. model but has not gone the U.K. route of attaching additional liability to the additional responsibilities now placed upon directors, particularly independent directors, as gatekeepers. Unlike the U.S. model and more akin to the *U.K. model, the Canadian model for gatekeeper liability* for lawyers assigns the essential regulatory function to the provincial law societies. The benefit of this model is that the problem of *conflicting standards in the U.S. between the Rules of Professional Conduct*, set by each state Bar Association and the SEC rules does not arise. It is also the case that the law societies are keenly aware of the competing tensions between lawyers' gatekeeping function and the confidentiality requirements that are required generally of all lawyers. However, *there is variation among the law societies to the extent that they have created specific rules to address lawyers*' gatekeeping functions. In the U.S., Sarbanes-Oxley imposed extensive federal regulation on the accounting profession. The act created the Public Company Accounting Oversight Board (PCAOB) to oversee the audit of public companies. *Accounting firms must register with* the PCAOB, which has broad powers to promulgate binding rules and standards, conduct investigations, and impose discipline; by shifting control of the accounting profession to a new body, the PCAOB aims to address the problem of accounting irregularities by establishing auditing standards and imposing professional discipline. The U.K.'s counterpart to the PCOAB is the *Financial Reporting Council* (FRC), an independent regulator for corporate reporting and governance,

created in April 2004 under the authority of the C(AICE) Act. The functions of the FRC include: establishing, monitoring, and enforcing accounting and auditing standards; regulating auditors; operating an independent investigation and disciplinary scheme for public interest cases; overseeing the regulatory activities of professional accountancy bodies; and promoting high standards of corporate governance.

Credit Rating Agencies Emerge as GateKeeper

Commentators such as Frank Partnoy see CRAs as possessing little informational value. While initial credit ratings guide purchases, it is unclear whether they provide any information beyond that already reflected in the "price talk" before a fixed instrument is issued. Building on this critique, the best reforms should create incentives for CRAs to generate more excellent informational value while reducing the impact of ratings on markets. In the current *American context,* Partnoy argues that CRAs are important not because they offer valuable information but because they grant issuers "regulatory licenses"— a good rating entitles the issuer to certain advantages related to regulation. The effectiveness of CRA's *gatekeeping role remains an open question*. However, public perception and academic writing suggest that the existing liability regime does not instil confidence in capital markets and that there is room for modernizing securities legislation to improve the current situation. Because of their unique intermediary role in capital markets, *conflicts often arise between an analyst's duty to provide independent, objective advice to investor clients and pressures to support investment banking revenues*. In the current context, buy-side pressures on financial analysts are increasing insignificance. For example, there is an incentive for a mutual fund with extensive holdings in stock to persuade an analyst not to put a "sell" recommendation on the stock that might contribute to a decline in its price. Recent reform efforts regarding the liability of investment advisors in different countries have not focused on their role as corporate gatekeepers. Instead, the focus has been on establishing consumer protection mechanisms to address power imbalances in investment advisors' relationships with customers. The evidence suggests that consumer protection issues are the most pressing concern in this context. In certain instances, there is an overlap between liability introduced for more general consumer protection purposes and liability for failure to perform a corporate gatekeeping function.

Conventional Analysis of Gatekeeper Liability: The primary failure of the traditional analysis of gatekeeper liability is that it did not sufficiently consider the dynamics of the group. Ignoring group dynamics, however, is inconsistent with

the way individuals operate in a business environment. This observation is not new. Law and economics scholars, often criticized by proponents of social psychology, recognized long ago that the nature of the corporation could be best understood by placing the individual into the group and recognizing the role of the individual within it. Ignoring group dynamics leads one back to a rational actor model of individualized action and stresses a "bad apples" approach to understanding corporate wrongdoing [John M. Darley (2005)]. It deemphasizes the influence one person or group of persons has on another, such as the interaction of a board of directors or the relationship between and among gatekeepers and their principals. This de-emphasis elides the complicated causes of misbehaviour and may prevent meaningful reform. Analysts of gatekeeper liability have ignored specific root causes of corruption. Corruption can begin with certain small steps that "have their origins in actions that are not themselves corrupt." Small or insignificant actions can spread within an organization, with each subsequent actor rationalizing that their conduct is not much different from conduct that preceded it.

Addressing gatekeepers' behaviour: In addressing gatekeepers' behaviour, ideas of agency cost theory and the nexus-of-contracts approach are overemphasized. This approach focuses on purported contractual relationships, such as an individual director and the corporation. It recognizes that a director's interests may diverge from the shareholders' and it considers ways shareholders can ensure that a director's interests are aligned with shareholders' interests. Under this view, a manager or director's fiduciary duty is nothing more than a safeguard to ensure he makes the right decisions on behalf of investors, as the residual claimants of the firm. However, the individualism characteristic of the contractualist view is inconsistent with board experience and fails as an explanatory theory of the recent business failures. The conventional analysis remains primarily wedded to a "command and control" (as opposed to a self-regulatory) corporate governance model. A command and control model relies on external sanctions and rewards, and a self-regulatory model relies on shaping employees' internal motivations.

Liability of Corporate Gate Keepers: They conceive gatekeepers as occupying a position within the larger legal framework and regarded liability as a mechanism to ensure the optimal deterrence of corporate wrongs. In this framework, wrongdoing could be directly deterred by the imposition of liability on corporations and individual corporate managers. Only where supplemental deterrence was required were gatekeepers to face potential liability to provide

prevent misconduct by a primary violator because the gatekeeper's expected liability or reputational harm from failing to prevent misconduct exceeded the benefits gained in fees. While this model has merits, it fails to distinguish among gatekeepers, likely to respond differently to incentives. It also fails to appreciate differences in the character of a gatekeeper's relationship with a primary violator and to consider whether such differences bear upon gatekeeper behaviour. All gatekeepers are not alike. They vary widely in their functions, skills necessary for the job, relationships with their principals, and duties they owe. There are differences in their approaches as well. Accounting determinations, for example, are often formalistic and unambiguous, while legal advice is said to be more nuanced, requiring an attorney to explore a range of options with a client, who evaluates the lawyer's advice and then makes up her mind. The securities analyst, unlike the accountant or lawyer, makes predictions, which are frequently wrong. Distinguishing among the character of gatekeepers' evaluations is helpful, but it masks more considerable differences in the structure of gatekeepers' relationships with their clients.

Under the strict liability regime, irrespective of fault, the gatekeepers would face liability for the wrongdoing of their corporate client. The gatekeepers must share the liability in some proportion, and because the fault is of no moment under a strict liability regime, they will do so in some fixed proportion unrelated to their respective contributions to the risk of wrongdoing (Lewis A. Kornhauser & Richard L. Revesz, (1989).

Compelling Cooperation Among Gatekeepers: Cooperation in this sense would involve gatekeepers sharing information and expertise to settle particular disclosure questions. The approach would promise to overcome, and thereby discourage, the practices of some clients or gatekeepers of failing to consult with other gatekeepers on some questions and of clients interposing themselves between gatekeepers. The approach would also promise to overcome the rigid separation of functions among various gatekeepers that may produce gaps in oversight as well as gatekeeper attempts to adopt a "head-in-the-sand approach" to avoid having to say "no" to a client [Herbert Smith, Hong Kong IPO Guide 18 (2006)]. An alternative proposal in a similar vein would be to permit, or even to require, a gatekeeper not simply to "report up" potential wrongdoing to a corporate client's general counsel or audit committee but to "report across" to other gatekeepers that have the expertise or other characteristics suited to assessing and deterring potential corporate wrongdoing. The treaty sets out the terms on which lawyers and accountants should cooperate, including emphasizing lawyers' professional responsibility to avoid "knowingly [participating] in any

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violation by the client of the disclosure requirements of the securities laws." An advantage of such a consultative approach is that it allows the crafting of terms of cooperation to account for differences in expertise among gatekeepers and preserve attorney-client privilege. Another area potentially calling for multiple gatekeeper precautions concerns disclosure of the results of independent investigations. Often conducted by law firms with narrow terms of reference, these investigations tackle sensitive issues, possibly going to the existence of securities fraud, and would require disclosure if their timing coincided with a business transaction.

Risk-shifting Among Gatekeepers: According to the Coase Theorem, voluntarily bargaining parties in a world without transaction costs will reach a mutually beneficial—and thus, efficient—an agreement where the opportunity exists for them to do so, provided legal rights are well-defined. While the Theorem was initially formulated in parties bargaining over property rights, its claim applies in the current context. A study of gatekeeper practices in securities transactions reveals that gatekeepers bargain among themselves to apportion liability arising from disclosure wrongs. Underwriters routinely adopt risk-shifting arrangements with other gatekeepers, namely accountants and lawyers, in response to potential liability. As a condition precedent to underwriting a proposed securities offering, underwriters will receive "comfort letters," which are also often referred to as "negative assurance letters," from other gatekeepers attesting to the accuracy of various parts of the registration statement.

Reforming Gatekeeping: People adopt positions that are likely to please others. By performing a significant volume of non-audit services for the audit client, the auditor had an overwhelming desire to please the client in the audit itself and continue to generate non-audit business. The SEC recognized this conflict in its own administrative rules adopted before Sarbanes-Oxley and sought to insulate the auditor from improper influence. The SEC prohibited auditors from providing certain non-audit services, such as consulting services, to audit clients because the hefty fees generated by such services could jeopardize the auditor's independence [Revision of the SEC's Auditor Independence Requirements, Securities Act. The auditor serves to correct the biases of managers, who are themselves dependent gatekeepers. The board chooses managers to further the ends of the corporation as a profitable enterprise to the benefit of the shareholders. Bias on the part of the managers is appropriate.

Unchecked; however, such bias can lead to abuse. Thus, the bias of the dependent gatekeeper is held in check by the independent gatekeeper. Rules are

designed to combat accountability to a general audience and enhance accuracy-based goals, discussed above. Certifying that an analyst's opinion represents his personal views helps ensure the analyst is not accountable to a third party, such as the issuer he is researching or the investment banking arm of the firm that employs him, which, acting as securities underwriter or strategic advisor, has its own directional goals in mind. Whether recent reforms have caused analysts to become independent once again is unknown. Evidence continues of retaliation and pressure on analysts from company officials and institutional investors to avoid sell recommendations. One should recognize that sell-side analysts have little incentive to issue a "sell" recommendation. Issuers generally do not like a "sell" recommendation because it might cause the stock to decline in value. Some evidence indicates that, in many cases, if enough analysts downgrade the stock, it can cost the CEO their job. The lawyers already have a clear obligation to make a report if they become "aware" of specific evidence. One possibility, therefore, is to require an annual certification to the SEC or the bar that a lawyer, covered by this rule, is either not aware of such evidence or has made the required report. This proposal should entail only modest tangible costs by attorneys (although it would likely result in emotional distress). Those appearing and practising before the SEC already must make the determinations that certification would require.

Conclusion

Recent reforms in the U.S. have not focused on imposing or modifying the liability to which underwriters are subject as gatekeepers. For example, Choi writes that underwriters face strong incentives to act as certifiers; if they can provide credible assurances that an issuer's disclosures are truthful, investors will be willing to pay more for the issuer's securities. *The issuer will then pay more for the underwriter's certification service. There is less need for underwriter liability if they are incentivized to become more independent and arguably better gatekeepers by the market for independent certifiers*. This argument applies to the Canadian context, suggesting that underwriters do not need to be subjected to additional liability. In examining the existing model where the boundaries between law and professional practice are somewhat blurred, and subsystems of liability that apply to various gatekeepers differ both from gatekeeper to gatekeeper and also geographically, it became apparent that participants in the market and other members of the public may not be aware of the extent of the existing corporate gatekeeper liability regime. Awareness of the liability scheme plays a crucial role in developing confidence in capital markets. Accordingly, a final recommendation is made regarding the widespread dissemination and availability of papers that seek to map out the existing gatekeeper liability regime

and situate it in the context of recent academic literature and reforms in comparable jurisdictions.

Recommendations

Establishing a private sector-led economic development operation of an efficient capital market is essential, featuring effective corporate governance. Corporate governance rules are generally embedded within the relevant acts, statutes, and laws guiding the corporations defining rights and obligations, including the dos and undo's of different stakeholders of business life. The whole business environment is influenced by complying with the rules of business crafted within the rules and procedures for every manufacturing, financial, service, utility, infrastructure and technology business. These finally create an environment for business that is popularly known as creating a better environment for doing business and for locals and foreigners. In the context of Bangladesh, the following are the recommendation for the improvement of corporate gatekeeping.

1. Ensure compliance with existing rules and procedures of corporate governance and corporate gatekeeping activities to minimize economic damages routing from gatekeeping failures and introduce incentives to reduce gatekeeping failures.
2. Conduct a study on the existing provisions of all corporate statutes framed for public and private sector entities and regulatory agencies to test the compatibility of relevant provisions for corporate keeping line with current market-led economic philosophy and recommend the desired changes to make those market-friendly.
3. Increase coordination among the gatekeeping agencies to share the information so that gap between the gatekeepers gets reduced. Organize workshops and seminars for the cross interest groups on the liabilities of the corporate environment's independent and dependent gate keepers.
4. Conduct extensive research on the comparative study among selective gatekeepers, both dependent and independent gatekeepers roles, responsibilities and liabilities within the country and compare them with developed market economies and emerging developing countries and competing regions of the globe.

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