Strategic Compliance

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Corporate compliance is at an inflection point. As courts, regulators, and prosecutors simultaneously but independently incentivize companies to develop bespoke compliance programs, corporate policies have evolved into an essential private ordering mechanism for customized compliance. Corporate policies serve not merely as guidelines for corporate employees; they also signal the level of a company's internal compliance mechanisms to external parties. Despite the ever-growing demand for the implementation of written corporate policies, how these policies are customized and monitored is largely unknown.

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Given the predominantly mandatory nature of regulatory compliance, how much discretion do corporate managers use — and how much should they use — in customizing compliance?

An analysis of original, hand-collected data on corporate policies from S&P 500 companies indicates that corporate managers actively customize not just compliance procedures, but also the definitional boundaries of compliance, either to be stricter or more lenient than is set by external regulations. For instance, the data show that most insider trading policies tend to have a broader definition of prohibited insider trading, while, in contrast, related party transaction policies often provide categorical exclusions that substantially narrow the definition of related party transactions. To better explain this puzzling trend of divergence, this Article introduces the concept of "strategic compliance," suggesting that corporate policies amplify companies' incentives to implement stringent internal monitoring where external enforcement is rigorous and adopt lenient internal monitoring where external enforcement is weak. However, it is essential to recognize that strategic compliance driven by external enforcement intensity, rather than tailored to each company's unique risks, can result in suboptimal allocation of compliance resources and undermine the benefits of customized compliance.

This Article's contribution is three-fold. First, it presents original, hand-collected empirical data from internal corporate policies, illuminating the prevailing trends in companies' customization of regulatory compliance. Second, it introduces the concept of strategic compliance as a novel theoretical framework that connects corporate compliance and corporate contract literature, providing insights into the strategic processes companies employ in tailoring their corporate policies. Third, it offers normative proposals to companies, shareholders, regulators, and prosecutors for more effective use of corporate policies and emphasizes the information-gathering functions of those policies.

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INTRODUCTION

Corporate compliance is at an inflection point,[1] putting pressure on companies to ensure their compliance programs more than ever before.[2] On January 17, 2023, the Department of Justice ("DOJ") Criminal Division's Corporate Enforcement Policy expanded prosecutors' discretion to corporate misconduct with aggravating factors[3] when three necessary conditions are met.[4] Those conditions include an effective compliance program "at the time of the misconduct," along with an immediate self-disclosure of the misconduct and extraordinary cooperation with DOJ.[5] The revision makes it clear that compliance

[1] *See* Veronica Root, *Coordinating Compliance Incentives*, 102 CORNELL L. REV. 1003, 1010 (2017) ("A focus on compliance within corporations has increased exponentially over the past two decades, and it appears poised to continue to grow in importance."); *see also* Sean J. Griffith, *Corporate Governance in an Era of Compliance*, 57 WM. & MARY L. REV. 2075, 2077 (2016) ("Over the past decade, compliance has blossomed into a thriving industry, and the compliance department has emerged, in many firms, as the co-equal of the legal department.").

[2] *See* Memorandum from John F. Savarese, Ralph M. Levene, David B. Anders & Sarah K. Eddy, Wachtell, Lipton, Rosen & Katz, DOJ Announces Revised Corporate Enforcement Policy (Jan. 19, 2023), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.28254.23.pdf [https://perma.cc/3MHK-7ENN] ("For our clients, the number one takeaway is that the value of an effective compliance program has never been greater.").

[3] *See* Kenneth A. Polite, Jr., Assistant Att'y Gen., U.S. Dep't of Just., Remarks on Revisions to the Criminal Division's Corporate Enforcement Policy (Jan. 17, 2023), https://www.justice.gov/opa/speech/assistant-attorney-general-kenneth-polite-jr-delivers-remarks-georgetown-university-law [https://perma.cc/SD2V-VDG8].

[4] The revision expanded prosecutors' discretion to corporate misconduct with aggravating factors (e.g., misconduct that poses a grave threat to national security or is deeply pervasive throughout the company), which prosecutors did not have discretion to decline its prosecution. *See* Memorandum from Lisa O. Monaco, Deputy Att'y Gen., U.S. Dep't of Just., to All U.S. Att'ys, Further Revisions to Corporate Criminal Enforcement Policies Following Discussions with Corporate Crime Advisory Group 7 (Sept. 15, 2022), https://www.justice.gov/opa/speech/file/1535301/download [https://perma.cc/62MY-KE3P] ("First, *absent the presence of aggravating factors,* the Department will not seek a guilty plea where a corporation has voluntarily self-disclosed, fully cooperated, and timely and appropriately remediated the criminal conduct." (emphasis added)).

[5] Existence of an effective compliance program "at the time of the misconduct" is one of three necessary conditions, along with self-reporting and cooperation, for declining prosecution even when misconduct relates to aggravating factors. *See* U.S. DEP'T OF JUST., 9-47.120 – CRIMINAL DIVISION CORPORATE ENFORCEMENT AND VOLUNTARY

programs should be put in place before misconduct occurs. This creates an incentive for companies to reinforce their front-end compliance efforts to prevent and detect misconduct before it escalates into a serious corporate crime.[6]

About a week later, on January 25, 2023, state corporate law also drew considerable attention to compliance programs.[7] In *McDonald's*, the Delaware Court of Chancery clarified for the first time that corporate officers, not just directors, also owe the fiduciary duty of oversight (i.e., a *Caremark* duty).[8] The oversight duty requires corporate fiduciaries to implement a reasonable reporting system, and to properly respond to red flags signaling compliance failure.[9] This decision exposes corporate officers to a new liability[10] and reaffirms the importance of compliance

SELF-DISCLOSURE POLICY 1-2 (2023), https://www.justice.gov/criminal-fraud/file/1562831/download [https://perma.cc/4EH4-EFTG]. Compliance programs are often revamped as part of the remediation process after misconduct. *See* Veronica Root Martinez, *Public Reporting of Monitorship Outcomes*, 136 HARV. L. REV. 757, 760 (2023) ("Remediation can take a variety of forms, from effectuating detailed mandates from a court or government regulator to creating a new compliance program.").

[6] Polite, *supra* note 3 ("A path that incentivizes even more robust compliance on the front-end, to prevent misconduct.").

[7] *See In re* McDonald's Corp. S'holder Derivative Litig., 289 A.3d 343, 350 (Del. Ch. 2023) ("The fact that corporate directors owe a duty of oversight does not foreclose officers from owing a similar duty. Just as a junior manager with supervisory duties can report to a senior manager with supervisory duties, so too can an officer with a duty of oversight report to a board of directors with a duty of oversight."); *see, e.g.*, John C. Coffee, Jr., *Crime and the Corporation: Making the Punishment Fit the Corporation*, 47 J. CORP. L. 963, 969 (2022) (discussing senior management's lack of incentives to rigorously oversee the activities of junior management); Alison Frankel, Commentary, *McDonald's Case is Wake-Up Call for Corporate Execs – Botch Oversight, Risk Liability*, REUTERS (Jan. 26, 2023, 1:18 PM PST), https://www.reuters.com/legal/government/mcdonalds-case-is-wake-up-call-corporate-execs-botch-oversight-risk-liability-2023-01-26/ [https://perma.cc/3MSE-C799] ("Chancery Court judge explicitly ruled . . . in a first-of-its-kind decision, that corporate officers owe a fiduciary duty of oversight to their company, just like the corporate board members.").

[8] *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996).

[9] *See* Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006); *In re* Boeing Co. Derivative Litig., No. 2019-0907, 2021 WL 4059924, at *25 (Del. Ch. Sept. 7, 2021).

[10] *See* Dylan Tokar, *McDonald's Ruling Shifts Oversight Liability Focus to Corporate Officers*, WALL ST. J. (Feb. 2, 2023, 6:49 PM EST), https://www.wsj.com/articles/mcdonalds-ruling-shifts-oversight-liability-focus-to-corporate-officers-11675381792?page=1 [https://perma.cc/84R5-MC2Y] (stating that the decision is "notable in the way it

programs to discharge their oversight duty.[11] Despite the ever-intensifying demand for companies' bespoke compliance programs, surprisingly little data exists on how companies are coping with the demand. This Article examines, both quantitively and qualitatively, the core of compliance programs: internal corporate policies.[12]

Corporate policies form a company's detailed action plan for incorporating compliance into day-to-day operations[13] and serve as blueprints for a company-wide compliance program. Once relatively

lays out some initial expectations for how executives should exercise their oversight duties"); Susan Reagan Gittes, Gregory V. Gooding, Elliot Greenfield, Maeve O'Connor & William D. Regner, *Delaware Court of Chancery Allows Caremark Claim Against Officer*, DEBEVOISE & PLIMPTON (Jan. 26, 2023), https://www.debevoise.com/-/media/files/insights/publications/2023/01/26_delaware-court-of-chancery-allows-caremark.pdf?rev=21302a049e5b40fb82b5ef5a26843998 [https://perma.cc/AW46-EAAG] ("[T]he factual nature of these claims as applied to officers seems likely to make them inviting targets for plaintiffs' lawyers."); Amy L. Simmerman, Lindsay Faccenda & Brad Sorrels, *Delaware Court of Chancery Concludes that Duty of Oversight Applies to Officers*, WILSON SONSINI (Jan. 26, 2023), https://www.wsgr.com/en/insights/delaware-court-of-chancery-concludes-that-duty-of-oversight-applies-to-officers.html [https://perma.cc/DV6D-NAYK] ("The court's decision clarifies an important but previously uncertain area of Delaware law pertaining to officers' fiduciary duties. Boards and officers will undoubtedly consider the implications of this decision within their own organizations.").

[11] *See infra* notes 88–99 and accompanying text.

[12] In this Article, the term "corporate policies" broadly refers to any corporate internal documents that corporate managers have the sole authority for implementation over the contents. This definition focuses on the fact that corporate insiders have wide discretion in customizing corporate policies. Corporate policies are under various names or labels (e.g., policies and procedures, guidelines, code, report, or statements) and cover a wide range of issues on corporate governance and compliance. The definition largely overlaps with the term "Shadow Governance Document," referring to "any non-charter, non-bylaw document that speaks to issues of corporate governance," coined by Professors Yaron Nili and Cathy Hwang in their influential article. Yaron Nili & Cathy Hwang, *Shadow Governance*, 108 CALIF. L. REV. 1097, 1105 (2020).

[13] In evaluating compliance programs, prosecutors should assess corporate policies' design, comprehensiveness, accessibility, responsibility for operational integration, and gatekeepers. *See* U.S. DEP'T OF JUST. CRIM. DIV., EVALUATION OF CORPORATE COMPLIANCE PROGRAMS 1, 4-5 (Mar. 2023), https://www.justice.gov/criminal-fraud/page/file/937501/download [https://perma.cc/X2E2-3FVM] [hereinafter EVALUATION OF CORPORATE COMPLIANCE PROGRAMS].

informal internal documents[14] written primarily for employees,[15] corporate policies have started coming to light, and have evolved into vital information sources for broader stakeholders and government authorities.[16] In recent years, various internal and external forces have contributed to the increased formalization and disclosure of corporate policies.[17] For instance, the DOJ counts a *written* corporate policy as an element of a good corporate compliance program.[18] Shareholders have

[14] *See* Faith Stevelman & Sarah C. Haan, *Boards in Information Governance*, 23 U. PA. J. BUS. L. 179, 241-42 (2020) (arguing that internal compliance, and risk management policies "reflect past corporate conduct and shape future conduct of the firms' constituencies").

[15] Internal corporate policies are an essential source for employees, not necessarily because they are the most authoritative rules, but because they are the most accessible rules for guiding day-to-day conduct.

[16] For federal enforcers' incentives to gather information in exchange for enforcement mitigation, see Jennifer Arlen & Samuel W. Buell, *The Law of Corporate Investigations and the Global Expansion of Corporate Criminal Enforcement*, 93 S. CAL. L. REV. 697, 704 (2020); Miriam Hechler Baer, *Governing Corporate Compliance*, 50 B.C. L. REV. 949, 954 (2009); Veronica Root Martinez, *The Government's Prioritization of Information over Sanction: Implications for Compliance*, 83 LAW & CONTEMP. PROBS. 85, 88 (2020).

[17] *See* Lisa M. Fairfax, *Stakeholderism, Corporate Purpose, and Credible Commitment*, 108 VA. L. REV. 1163, 1212 (2022) ("[I]n an environment where shareholders and other stakeholders have demonstrated a desire for greater sustainability disclosure, [the SEC's] mandated disclosure increases the likelihood that companies without particular policies and practices will adopt them to ward off potential shareholder and stakeholder backlash."); Stavros Gadinis & Amelia Miazad, *The Hidden Power of Compliance*, 103 MINN. L. REV. 2135, 2147 (2019) ("Faced with a proliferation of new rules and regulations, both from Congress and from an ever-growing administrative state, federal authorities looked for strategies to further incentivize private companies to toe the line."); *see also* Geoffrey Parsons Miller, *The Compliance Function: An Overview*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 981, 990-92 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2015).

[18] Leslie R. Caldwell, Assistant Att'y Gen. for Crim. Div., U.S. Dep't of Just., Remarks by Assistant Attorney General for the Criminal Division Leslie R. Caldwell at the 22nd Annual Ethics and Compliance Conference (Oct. 1, 2014), https://www.justice.gov/opa/speech/remarks-assistant-attorney-general-criminal-division-leslie-r-caldwell-22nd-annual-ethics [https://perma.cc/5GPK-R7TU] ("But there are hallmarks of good compliance programs. . . . 2. *Written* Policies. A company should have a clearly articulated and visible corporate compliance policy memorialized in a written compliance code. Again, employees need to know what to do — or not do — when faced with a tough judgment call involving business ethics." (emphasis added); *see* Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate*

also challenged corporate policies on specific issues[19] using shareholder proposals[20] or litigation.[21] Furthermore, regulators increasingly require

Liability Regimes, 72 N.Y.U. L. REV. 687, 706 (1997) ("*Ex ante* policing generally assumes the form of continuous monitoring under an ongoing compliance program.").

[19] *See, e.g.*, HEIDI WELSH & MICHAEL PASSOFF, AS YOU SOW, PROXY PREVIEW 2023, at 38 (2023), https://www.asyousow.org/reports/proxy-preview-2023 [https://perma.cc/P2ZS-4T8K] ("As of mid-February, there are 30 proposals on lobbying, 28 on elections and 35 on other issues, all but one concerning mismatches between corporate policies and recipients' viewpoints.").

[20] *See, e.g.*, Jill E. Fisch, *Purpose Proposals*, 1 U. CHI. BUS. L. REV. 113, 147 (2022) [hereinafter *Purpose Proposals*] ("Yet precatory proposals have become an increasingly powerful tool. As institutional investors increasingly vote independently of management recommendations, shareholder proposals are more likely to obtain majority support."); Sarah C. Haan, *Shareholder Proposal Settlements and the Private Ordering of Public Elections*, 126 YALE L.J. 262, 265 (2016) [hereinafter *Shareholder Proposal Settlements*] ("The shareholder proposal settlement has become increasingly popular as a tool for negotiating private rules for corporations on matters that are, by long tradition, subjects of public regulation."); Roberto Tallarita, *Stockholder Politics*, 73 HASTINGS L.J. 1697, 1717 (2022) ("In fact, the [shareholder] proposal included some specific actions . . . which were presented as mere examples of what the report could discuss but were clearly meant to provide concrete suggestions about specific policies to implement."). Despite their influence over portfolio companies' corporate governance issues, asset managers do not seem to actively monitor compliance policies. None of the top three asset managers (BlackRock, Vanguard, and State Street)'s nor major proxy advisors' (ISS and Glass Lewis) 2023 voting guidelines mention portfolio companies' compliance policies. BLACKROCK INVESTMENT STEWARDSHIP, PROXY VOTING GUIDELINES FOR U.S. SECURITIES (2023), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf [https://perma.cc/H576-F846]; GLASS LEWIS, 2023 POLICY GUIDELINES – UNITED STATES (2022), https://www.glasslewis.com/wp-content/uploads/2022/11/US-Voting-Guidelines-2023-GL.pdf [https://perma.cc/6C6Z-XP3B]; INSTITUTIONAL S'HOLDER SERVS., UNITED STATES PROXY VOTING GUIDELINES: BENCHMARK POLICY RECOMMENDATIONS (2022), https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf?v=1 [https://perma.cc/YEJ9-ZNTW]; STATE ST. GLOB. ADVISORS, NORTH AMERICA PROXY VOTING AND ENGAGEMENT GUIDELINES (2023), https://www.ssga.com/library-content/pdfs/asr-library/proxy-voting-and-engagement-guidelines-us-canada.pdf [https://perma.cc/9FP9-SSRX]; VANGUARD, PROXY VOTING POLICY FOR U.S. PORTFOLIO COMPANIES (2023), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/us_proxy_voting_2023.pdf [https://perma.cc/S8QR-P7EJ].

[21] *See, e.g.*, Jessica Erickson, *The Lost Lessons of Shareholder Derivative Suits*, 77 WASH. & LEE L. REV. 1131, 1151 (2020) ("In several of settlements . . . the corporation agreed to change its policies on executive compensation or self-interested transactions.");

companies to implement and disclose corporate policies on various issues.[22] For example, the U.S. Securities and Exchange Commission ("SEC") adopted two new disclosure requirements for *written* policies on insider trading and executive compensation clawbacks in 2022.[23] In response to these burgeoning demands, companies have been producing more written corporate policies[24] and making them publicly available on their websites,[25] providing outsiders with insights into the internal decision-making process.[26]

Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J.L. ECON. & ORG. 55, 63 (1991) (explaining that structural settlements changing policies related to executive compensation or self-interested transactions can justify attorneys' fees by demonstrating a benefit to the corporation).

[22] *See* Veronica Root Martinez, *Complex Compliance Investigations*, 120 COLUM. L. REV. 249, 295 (2020) ("Legal and regulatory interventions, and sometimes even industry standards, often require firms to adopt particular programs and policies.").

[23] *See* Insider Trading Arrangements and Related Disclosures, 87 Fed. Reg. 80362 (Dec. 29, 2022) (codified at 17 C.F.R. pts. 229, 232, 240, 249); Listing Standards for Recovery of Erroneously Awarded Compensation, 87 Fed. Reg. 73076 (Nov. 28, 2022) (codified at 17 C.F.R. pts. 229, 232, 240, 249, 270).

[24] *See* Afra Afsharipour, *Women and M&A*, 12 U.C. IRVINE L. REV. 359, 372 (2022) ("As advisors, directors use their experience and expertise to guide management in designing corporate strategies and policies."); Dorothy S. Lund & Elizabeth Pollman, Essay, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2596 (2021) ("Many companies proactively adopt governance policies that mesh with ISS and Glass Lewis recommendations.").

[25] Companies rarely submit corporate policies as an exhibit in their SEC filings. Besides summarizing in a few sentences in proxy materials, most companies do not publicize stand-alone corporate policies. *See* Bradford (Lynch) Levy & Daniel J. Taylor, The Information Content of Corporate Websites (Feb. 2022) (unpublished manuscript), https://ssrn.com/abstract=3791474 [https://perma.cc/PWT6-HNRJ] (finding corporate websites serve as "information intermediaries that supplements traditional disclosure channels"). *But see* Haan, *supra* note 20, at 310 n.176 ("Although a settlement agreement [between shareholder proposal proponents and corporate management] typically establishes a corporate policy, the policy itself is not always publicly available on the company's website."); Nili & Hwang, *supra* note 12, at 1119 ("The rationales behind those disclosures, however, may vary. Some companies may have conduct policies but choose not to disclose them.").

[26] *See* Nili & Hwang, *supra* note 12, at 1106 ("Shadow governance documents can influence the way management and corporations behave, but shareholders have little say, systematically, in the content of these documents.").

Corporate policies are a prime example of private ordering.[27] However, existing literature on the roles and limits of corporate private ordering has mostly focused on corporate *governance* issues,[28] and little is known about the interaction between corporate *compliance* and

[27] *See* Jill E. Fisch, *The New Governance and the Challenge of Litigation Bylaws*, 81 BROOK. L. REV. 1637, 1638 (2016) (defining private ordering as individual "issuer-specific rules that are contractual in nature (as opposed to statues, agency rules, or decisional law)"). *See generally* Jonathan R. Macey, *Public and Private Ordering and the Production of Legitimate and Illegitimate Legal Rules*, 82 CORNELL L. REV. 1123, 1140 (1997) (contending that private ordering provides a more efficient allocation of resources than public ordering); Steven L. Schwarcz, *Private Ordering*, 97 NW. U. L. REV. 319, 322-23 (2002) (proposing that consideration of "distributional and other nonefficiency regulatory goals" would promote the legitimacy of private ordering); J.S. Nelson, Corporate Criminal ESG 43 (Mar. 23, 2023) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4240029 [https://perma.cc/HC6J-YEFQ] ("[B]usinesses recognize that there has been a hollowing out of U.S. regulatory resources, and . . . the U.S. government effectively permits companies to regulate themselves.").

[28] *See* Ian Ayres, *Menus Matter*, 73 U. CHI. L. REV. 3, 6 (2006); Michal Barzuza, *Inefficient Tailoring: The Private Ordering Paradox in Corporate Law*, 8 HARV. BUS. L. REV. 131, 138-141 (2018); Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329, 331-33 (2010); Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 NW. U. L. REV. 542, 544 (1990); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1420 (1989) ("The fifty states offer different menus of devices. . . . These include not only rules about governance structures but also fiduciary rules and prohibitions of fraud."); Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CALIF. L. REV. 373, 400-03 (2018) [hereinafter *Governance by Contract*]; Jill E. Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 WASH. U. L. REV. 913, 923-26 (2021) [hereinafter *Stealth Governance*]; Jens Frankenreiter, Cathy Hwang, Yaron Nili & Eric Talley, *Cleaning Corporate Governance*, 170 U. PA. L. REV. 1, 26-27 (2021); Henry Hansmann, *Corporation and Contract*, 8 AM. L. & ECON. REV. 1, 2 (2006); Kobi Kastiel & Yaron Nili, *The Corporate Governance Gap*, 131 YALE L.J. 782, 800-02 (2022); Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1331 (2013); Dorothy S. Lund, Response, *In Search of Good Corporate Governance*, 131 YALE L.J.F. 854, 857-58 (2022); Geeyoung Min, *Shareholder Voice in Corporate Charter Amendments*, 43 J. CORP. L. 289, 292 (2018) [hereinafter *Shareholder Voice in Corporate Charter Amendments*]; Kishanthi Parella, *Contractual Stakeholderism*, 102 B.U. L. REV. 865, 875-77 (2022); Gabriel V. Rauterberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 YALE. J. ON REGUL. 1124, 1131 (2021); Megan Wischmeier Shaner, *Interpreting Organizational "Contracts" and the Private Ordering of Public Company Governance*, 60 WM. & MARY L. REV. 985, 1005 (2019).

private ordering.[29] While corporate governance and corporate compliance increasingly overlap and influence each other,[30] the predominantly mandatory nature of regulations[31] raises fundamental questions: how much discretion do corporate managers actually use, and how much *should* they use in customizing compliance through corporate policies?

To understand how corporate managers exercise their discretion in customizing their internal corporate policies, this Article analyzes original, hand-collected data[32] on corporate policies from the Standard and Poor's ("S&P") 500 companies' websites about two key issues: insider trading and related party transactions.[33] Stand-alone corporate policies provide the most comprehensive, accurate depiction of how

[29] Professors Florencia Marotta-Wurgler and Kevin Davis empirically examined the interplay between companies' contractual flexibility and compliance surrounding privacy policies posted on companies' websites. In the sense that those privacy policies are "typically incorporated by reference in the general Terms of Service contracts, to which users must agree," they are more formal contract terms that bind contracting parties rather than informal/internal corporate policies analyzed in this Article. Kevin E. Davis & Florencia Marotta-Wurgler, *Contracting for Personal Data*, 94 N.Y.U. L. REV. 662, 663 (2019); *see also* Florencia Marotta-Wurgler, *Self-Regulation and Competition in Privacy Policies*, 45 J. LEGAL STUD. 13, 17 (2016).

[30] *See* Baer, *supra* note 16, at 952; Lawrence A. Cunningham, *Deferred Prosecutions and Corporate Governance: An Integrated Approach to Investigation and Reform*, 66 FLA. L. REV. 1, 14 (2014); Griffith, *supra* note 1, at 2078.

[31] *See* Martinez, *supra* note 22, at 295 ("These mandated elements of a firm's compliance program tend to focus on policing and structural components because those are relatively easy to impose on a firm."). The mandatory nature of corporate compliance and the discretionary nature of corporate governance are predominant but with exceptions. For instance, publicly traded companies are subject to certain mandatory corporate governance requirements from various external authorities, including the majority independent board (stock exchange rules), annual shareholder meetings (state corporate law), and shareholder voting on executive compensation (per the SEC Rules). On the other hand, corporate managers can wield discretion in customizing procedural aspects of corporate compliance and business ethics issues.

[32] *See infra* Appendix.

[33] The SEC rule mandates disclosure of a *related party transactions* policy but does not necessarily ask for a stand-alone written policy. 17 C.F.R. § 229.404(b)(1) (2023). Thus, most companies tend to disclose a summary of their policies and procedures in their proxy statements, rather than disclosing all the details of a stand-alone policy on their websites.

companies customize their internal control,[34] and this Article is the first study that compares stand-alone corporate policies on multiple compliance issues.[35] A primary finding from the original data, supplemented with interviews with practitioners, is that companies not only customize procedures to ensure compliance with external laws,[36] but they often further modify the definitional boundaries of prohibited actions set by external laws.[37] A puzzling twist is that the boundary customization occurs in both the stringent and lenient directions, depending on the issues.[38]

The first set of sample corporate policies deals with insider trading — trading of securities using material, nonpublic information.[39] Insider

[34] This Article acknowledges that the data is only from the largest companies that choose to disclose the policies on their websites. As the disclosure history is untraceable, this Article focuses on the question of how corporate policies are drafted, rather than why they are disclosed. To make sure the trend shown in the sample policies reflects the prevalent trend in the broader business community, I also conducted qualitative interviews with in-house counsel.

[35] This Article differs from prior research analyzing insider trading policies in terms of its data source and focus. *See* Laura Nyantung Beny & Anita Anand, *Private Regulation of Insider Trading in the Shadow of Lax Public Enforcement: Evidence from Canadian Firms*, 3 HARV. BUS. L. REV. 216, 237 (2013) (using publicly available 167 TSX/S&P listed Canadian companies' insider trading policies to test determinants for the *procedural* stringency of policies); J.C. Bettis, J.L. Coles & M.L. Lemmon, *Corporate Policies Restricting Trading by Insiders*, 57 J. FIN. ECON. 191, 195 (2000) (using the survey of 403 firms on their insider trading policies, both written and *non-written*, to test the efficacy of the policies); Alan D. Jagolinzer, David F. Larcker & Daniel J. Taylor, *Corporate Governance and the Information Content of Insider Trades*, 49 J. ACCT. RSCH. 1249, 1253 (2011) (collecting 260 firms' stand-alone insider trading policies by scraping their websites in 2006 and 2007 and by directly requesting the policy from companies to empirically test the impact of the *general counsel's approval requirement* on insider trading activities).

[36] *See* Baer, *supra* note 16, at 955 ("[I]nternal corporate compliance programs are the instrumentalities of hard law: formal regimes designed to supply internal monitoring and punishment, so that the firm can then assist the government in fulfilling its duties of external monitoring and punishment.").

[37] *See infra* Parts II.A.2, II.B.2.

[38] *Id.*

[39] This Article does not aim to review the extensive literature on insider trading nor to propose how insider trading law should be changed. Instead, it focuses on how companies' corporate policies strategically respond to the current legal regime. *See generally* Kevin R. Douglas, *How Fatal Ambiguity Undermines Effective Insider Trading Reform*, 48 J. CORP. L. 353, 360 (2023) ("The disconnect between disclosure and consent

trading is strictly prohibited under federal law,[40] but what exactly the term "insider trading" entails is unclear because neither Congress nor the SEC has expressly defined it.[41] Its definition has evolved mainly through federal common law,[42] and companies tend to define prohibited insider trading in their corporate policies as broadly as possible.[43] Analysis of the sample insider trading policies[44] shows that such

creates the distance between insider trading law and common law fraudulent nondisclosure or unjust enrichment cases."); Donna M. Nagy, *Insider Trading and the Gradual Demise of Fiduciary Principles*, 94 IOWA L. REV. 1315, 1318 (2009) ("[W]hereas the classical theory 'premis[es] liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information.'" (quoting United States v. O'Hagan, 521 U.S. 642, 652 (1997)); James J. Park, *Insider Trading and the Integrity of Mandatory Disclosure*, 2018 WIS. L. REV. 1133, 1133 (2018) (arguing that "protecting the integrity of mandatory disclosure is a compelling reason for insider trading regulation").

[40] Insider trading is illegal under SEC Rule 10b-5, adopted pursuant to Section 10 of the Securities Exchange Act of 1934, which prohibits securities fraud. 17 C.F.R. § 240.10b-5 (2023); 15 U.S.C. § 78j(b). In 2022, the SEC adopted a new rule regarding insider trading. Insider Trading Arrangements and Related Disclosures, 87 Fed. Reg. 80362, 80362-63 (Dec. 29, 2022) (codified at 17 C.F.R. pts. 229, 232, 240, 249) ("The securities laws' antifraud prohibitions that proscribe insider trading, including Section 10(b) of the Exchange Act, play an essential role in maintaining the fairness and integrity of our securities markets. . . . [Insider trading] harms not only individual investors but also undermines the foundations of our markets by eroding investor confidence."); *see also* Jesse M. Fried, *Insider Trading via the Corporation*, 162 U. PA. L. REV. 801, 808 (2014).

[41] *See* Jill E. Fisch, *Constructive Ambiguity and Judicial Development of Insider Trading*, 71 SMU L. REV. 749, 757 (2018) [hereinafter *Constructive Ambiguity*] ("[B]ecause § 10(b) is an 'open-textured statute,' its interpretation requires the courts to engage in the more expansive interpretive exercise associated with common law adjudication."); Park, *supra* note 39, at 1179 ("The law of insider trading has often been criticized for its failure to establish a clear boundary between permissible and impermissible trading."); Andrew Verstein, *Insider Tainting: Strategic Tipping of Material Nonpublic Information*, 112 NW. U. L. REV. 725, 739 (2018) ("No statute or rule defines 'insider trading.'").

[42] *See infra* Part II.A.1; *see also* Park, *supra* note 39, at 1139-48.

[43] *See infra* Parts II.A.2–4.

[44] This original analysis of actual contents of insider trading policies aims to complement the existing literature on insider trading compliance programs. *See, e.g.*, Stephen M. Bainbridge, *Insider Trading Compliance Programs*, *in* THE CAMBRIDGE HANDBOOK OF COMPLIANCE 855, 855 (Benjamin van Rooij & D. Daniel Sokol eds., 2021) (providing an overview of corporate insider trading compliance programs, the federal insider trading prohibition, and why corporations adopt compliance programs); John P.

expansive insider trading prohibition is prevalent across companies. Approximately seventy-six percent of the disclosed, stand-alone insider trading policies from S&P 500 companies prohibit the trading of *any other* publicly traded companies' stock based on material, nonpublic information.[45] Such broad prohibitions entail significant legal consequences, as hinted at in a recent case decided on January 14, 2022.[46] In *SEC v. Panuwat*, the court said that the trading of a separate third party company's stock could fall under the SEC's "misappropriation theory" of insider trading,[47] particularly because the trader breached the fiduciary duty to his employer *by not complying with its insider trading policy*,[48] which prohibits insider trading more expansively than federal securities law does.[49] As the trader would not have violated federal

Anderson, *Solving the Paradox of Insider Trading Compliance*, 88 TEMP. L. REV. 273, 273 (2016) (proposing solutions to the current insider trading compliance programs); Steven Chasin, *Insider v. Issuer: Resolving and Preventing Insider Trading Compliance Policy Disputes*, 50 UCLA L. REV. 859, 859 (2003) (proposing a business judgment standard for insider trading compliance disputes).

[45] *See infra* Part II.A.2. Also, approximately 52% of the hand-collected Code of Ethics from S&P 500 companies prohibits the trading of *any other* company's stock. These sources are on file with the author.

[46] SEC v. Panuwat, No. 21-cv-06322, 2022 WL 633306, at *8 (N.D. Cal. Jan. 14, 2022) ("[Panuwat] argues 'no one . . . ever understood the insider trading laws to prohibit the type of conduct alleged.' . . . It is true that there appear to be no other cases where the material nonpublic information at issue involved a third party. The SEC conceded this at oral argument."); *see also infra* Part II.A.4.

[47] *Panuwat*, 2022 WL 633306, at *1. The SEC claimed that defendant's (Mr. Panuwat's) use of inside information — that Pfizer would acquire his employer (Medivation) — to buy stock of another comparable mid-size company (Incyte) in the same industry was illegal. As Mr. Panuwat expected, the stock price of Incyte, as a potential target, surged by about eight percent after the announcement of the Pfizer-Medivation acquisition deal.

[48] *Id.* at *6; *see also* Edward Imperatore & Jackie Liu, *Takeaways for In-House Counsel from the SEC's "Shadow Insider Trading" Action*, MORRISON FOERSTER (Mar. 7, 2022), https://www.mofo.com/resources/insights/220307-shadow-insider-trading [https://perma.cc/YS8X-G75Q] ("The court's assessment of whether the SEC adequately alleged that Panuwat had breached his duty to Medivation turned entirely upon the expansive wording of Medivation's insider trading policy. The court did not consider whether Panuwat's conduct would have been unlawful absent a written insider trading policy prohibiting it.").

[49] Although this was the first case where a court recognized the validity of the internal expansion of insider trading prohibition under misappropriation theory, its

insider trading law if the corporate policy had not broadly defined insider trading, the case demonstrates how internal corporate policies can affect external regulators, courts, and other companies.[50]

On the other side of the spectrum, however, companies can narrow the scope of prohibited actions, which makes corporate policies more lenient than applicable external rules.[51] The second set of sample corporate policies governs related party transactions (i.e., transactions between a company and its officers, directors, or controlling shareholders), a subset of a typical self-dealing transaction where an individual's personal interests potentially conflict with the interests of the company.[52] Due to the potential conflicts of interest and potential harm such transactions can impose on the company,[53] publicly traded

doctrinal implication of such expanded insider trading prohibition has been theoretically alluded to. *See, e.g.*, Ian Ayres & Joe Bankman, *Substitutes for Insider Trading*, 54 STAN. L. REV. 235, 239 (2001) (noting that under the misappropriation theory, "[a]n employee is a fiduciary of her employer. If a company explicitly prohibits its employees from using nonpublic information to trade in another company's stock, an employee who violates that prohibition will violate Section 10(b)").

[50] The court's recognition of the expanded insider trading prohibition in the corporate policy prompted other firms to revisit their insider trading policies. *See, e.g.*, Tami Stark, Colin J. Diamond, Maia Gez, Scott Levi & Michelle Rutta, *Time to Revisit Insider Trading Policies: The SEC's Expansion of Insider Trading Enforcement to "Shadow Trading" Survives Motion to Dismiss*, WHITE & CASE (Feb 2, 2022), https://www.whitecase.com/insight-alert/time-revisit-insider-trading-policies-secs-expansion-insider-trading-enforcement [https://perma.cc/LZ2G-NXUF] ("This decision, combined with the SEC's recent proposal strengthening the requirements for Rule 10b5-1 insider trading plans, puts companies and traders on notice that the SEC may aggressively pursue novel theories of insider trading. As a result, companies should consider including, . . . explicitly restricting in their insider trading policies trading by insiders in third-party companies that could be considered 'economically linked.'").

[51] *See infra* Parts II.B.2–3.

[52] *See, e.g.*, Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560, 606 (2016) (discussing a framework for distinguishing self-dealing from a legitimate transaction).

[53] Even the *appearance* of a conflict of interest may violate the code of ethics, which is another ubiquitous internal corporate policy. *See, e.g.*, TESLA, CODE OF BUSINESS ETHICS 5 (Dec. 10, 2021), https://tesla-cdn.thron.com/static/D4EJXC_business-code-of-ethics_UOAY2V.pdf?xseo=&response-content-disposition=inline%3Bfilename%3D%22code_of_business_and_ethics.pdf%22 [https://perma.cc/8LFH-RJHF] ("A conflict of interest may arise whenever your personal interests interfere, or *appear to interfere*, with Tesla's

companies' related party transactions are subject to a set of external regulations[54]: SEC regulations,[55] major stock exchange listing rules,[56] and state corporate law.[57] Despite the multiple layers of external rules that overlap on the same compliance issue, companies tend to wield a significant amount of discretion in coordinating the rules in their related party transaction policies.[58]

Contrary to the trend among insider trading policies, eighty-one percent of related party transaction policies grant categorical waivers, narrowing the scope of prohibited transactions.[59] If a transaction falls

interests. . . . In some cases, even the *appearance* of a conflict of interest can be as damaging to Tesla's reputation as an actual one." (emphasis added)).

[54] *See* Geeyoung Min, *The SEC and the Courts' Cooperative Policing of Related Party Transactions*, 2014 COLUM. BUS. L. REV. 663, 676-80 (2014) [hereinafter *Cooperative Policing*].

[55] *See* 17 C.F.R. § 229.404(b)(1) (2023). The SEC requires public companies to disclose "policies and procedures for the review, approval, or ratification" of related party transactions, but it does not guide or evaluate the content of the policies and procedures. For the limits of the SEC's disclosure-focused regulations, see Fairfax, *supra* note 17, at 1218 ("In the context of disclosure, rather than policing noncompliance with substantive conduct, the SEC will be limited to policing for inaccuracies and misleading information. This means that so long as corporations accurately disclose, corporations can engage in problematic behaviors without facing regulatory consequences.").

[56] *See, e.g.*, NASDAQ, STOCK MARKET LLC RULES § 5630(a), https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5600-series (last visited July 28, 2023) [https://perma.cc/9GL5-QVSL] [hereinafter NASDAQ LISTING RULES] (requiring an "independent body of the board of directors" to review all related party transactions); NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL § 314.00, https://nyse.wolterskluwer.cloud/listed-company-manual/09013e2c85582e1f (last visited July 28, 2023) [https://perma.cc/AJK6-823Z] [hereinafter NYSE LISTED COMPANY MANUAL] (requiring an "independent body of the board of directors" to review all related party transactions).

[57] *See, e.g.*, DEL. CODE ANN. tit. 8, § 144 (2023) (describing the conditions under which a self-interested transaction is not void *per se*). Under state corporate law, both *ex ante* screening mechanisms (e.g., disclosure and approval) and *ex post* remedy (e.g., litigation) are used for effective monitoring of related party transactions. Tax Code (26 U.S.C. § 267) and Public Company Accounting Oversight Board (PCAOB) AS 2410 also address related party transactions, but they are not directly relevant to disclosures of non-financial information, which is the focus of this Article. *See* Min, *Cooperative Policing*, *supra* note 54, at 679.

[58] *See infra* Part II.B.

[59] *See infra* Appendix.

under the categorical exceptions predetermined by a company's related party transaction policy,[60] a corporate insider does *not* need to disclose the transaction to the company.[61] Such categorical waivers can create information blackouts on related party transactions, which could potentially undermine the cleansing mechanism under corporate law.

These findings from two different types of corporate policies indicate that companies actively tailor the scope of prohibited actions in corporate policies to push what external regulations limit to an unprecedented degree, particularly when legal ambiguity exists or when the gap to fill is wider.[62] The findings provide an important update to the prevalent perception that corporate policies are designed to set up internal procedures.[63] At the same time, the divergence in stringency

[60] For example, company A's donation to non-profit organizations managed by company A's executives or directors.

[61] 71% of the sample policies delegate insiders (e.g., general counsel) to approve related party transactions without disclosing them to a committee of independent directors. Taken together, 61% of S&P 500 companies' stand-alone related party transaction policies have both categorical waivers and insider screenings. Sample policies and the analysis are on file with the author. *See also* William W. Bratton, *Reconsidering the Evolutionary Erosion Account of Corporate Fiduciary Law*, 76 BUS. LAW. 1157, 1203-04 (2021) (discussing the nature of self-interested transactions reported by listed companies); Andrew F. Tuch, *Reassessing Self-Dealing: Between No Conflict and Fairness*, 88 FORDHAM L. REV. 939, 995-98 (2019) (analyzing 100 randomly selected Delaware companies' related party transaction policies disclosed in companies' *proxy statements* to see the variance in approving entities for related party transactions across the sample companies).

[62] When there is room for interpretation in the external law, companies need to clarify what is allowed or forbidden under relevant external regulations. Professor John Anderson argues that the uncertainty surrounding insider trading leads companies to implement "highly restrictive" compliance programs "marked by highly restrictive preclearance decision making and extended blackout periods." However, those are *procedural* customizations, and whether definitional customization revealed in this Article should be allowed to mitigate or eliminate legal vagueness is still in question. *See* Anderson, *supra* note 44, at 295; *see also* Nicholas Calcina Howson, *Enforcement Without Foundation? – Insider Trading and China's Administrative Law Crisis*, 60 AM. J. COMPAR. L. 955, 955-56 (2012) (showing how the uncertainty exacerbated by China's insider trading enforcement pursuant to internal "guidance" can harm its capital market.).

[63] *See* Baer, *supra* note 16, at 955 ("[I]nternal corporate compliance programs are the instrumentalities of hard law: formal regimes designed to supply internal monitoring and punishment, so that the firm can then assist the government in fulfilling its duties of external monitoring and punishment."); Kenneth Bamberger, *Regulation as Delegation:*

reveals companies' compliance strategies in their corporate policy making.[64] Why do corporate managers tend to relax internal policies on related party transactions while ratcheting up the scrutiny of insider trading?

This Article discusses why the most prevalent theories (agency cost theory and efficiency theory) in the business law sphere cannot fully explain the divergence of stringency in corporate policies.[65] It then proposes a complementary theory that suggests companies use their contractual freedom primarily in response to external enforcement intensity[66]rather than to company-specific risks.[67] Changes in corporate behavior in response to external enforcement intensity are not new,[68] but how they are systematically amplified in corporate private ordering has not been previously examined. Corporate policies amplify the incentives to implement stringent internal monitoring where external enforcement is rigorous and adopt lenient internal monitoring where external enforcement is weak,[69] what this Article calls "strategic compliance."

Private Firms, Decisionmaking and Accountability in the Administrative State, 56 DUKE L.J. 377, 377-38 (2006).

[64] One might initially think that the divergence stems primarily from the differences in corporate characteristics (e.g., industry, ownership structure, firm size, state of incorporation). However, the data indicates otherwise. 88% of the S&P 500 companies that disclose both their insider trading policies and related party transaction policies to the public adopt a stricter insider trading policy while implementing a more lenient related party transaction policy. This information hints that even in the same companies (i.e., even when all relevant conditions are the same), strict insider trading policies and lax related party transaction policies tend to coexist.

[65] *See infra* Part II.C.1.

[66] The intensity of external enforcement is determined by (1) the likelihood of detection, and (2) the level of penalty.

[67] *See infra* Part II.C.1.

[68] *See, e.g.*, Jennifer Arlen & Lewis A. Kornhauser, *Battle for Our Souls: A Psychological Justification for Corporate and Individual Liability Organizational Misconduct*, 2023 U. ILL. L. REV. 673 (2023) (discussing the efficacy of various regulatory regimes in deterring organizational misconduct); Brandon L. Garrett & Gregory Mitchell, *Testing Compliance*, 83 LAW & CONTEMP. PROBS. 47 (2020) (exploring how the current regulatory environment does not incentivize efficient or effective compliance policies).

[69] *See infra* Part II.C.1.

Strategic compliance itself is not necessarily problematic because legal risks must be factored into cost-benefit analysis to decide a company's compliance investment.[70] The current practice of extreme strategic compliance, however, may significantly compromise the benefits of private ordering when companies expand or narrow the definitional boundaries of prohibited actions. First, such modified definitions can create a regulatory vacuum on certain compliance issues (e.g., categorical waivers of related party transactions), not because they are inherently frivolous,[71] but rather because of the external authority's limited access to inside information.[72] Thus, strategic compliance can

[70] *See* Vikramaditya S. Khanna, *Compliance as Costs and Benefits*, *in* THE CAMBRIDGE HANDBOOK OF COMPLIANCE, *supra* note 44, at 13, 13; Donald C. Langevoort, *Compliance as Liability Risk Management*, *in* THE CAMBRIDGE HANDBOOK OF COMPLIANCE, *supra* note 44, at 123, 123.

[71] The risk of extracting private benefits through conflicted transactions is not just a theoretical question; it raises concerns in the market relatively quickly and significantly. We Co. (renamed from WeWork)'s first IPO attempt was questioned (and eventually failed) after the company's related party transactions with a founder (Adam Neumann) and his family were revealed. *See, e.g.*, Donald C. Langevoort & Hillary A. Sale, *Corporate Adolescence: Why Did "We" Not Work?*, 99 TEX. L. REV. 1347, 1370 (2021) ("In short, the culture bred conflicts at all levels, and because investors and board members alike were involved, no one had an incentive to say no."); Eliot Brown, *WeWork's Long List of Potential Conflicts Adds to Questions Ahead of IPO*, WALL ST. J. (Sept. 6, 2019, 6:26 PM EST), https://www.wsj.com/articles/weworks-long-list-of-potential-conflicts-adds-to-questions-ahead-of-ipo-11567808023 [https://perma.cc/9QWH-BLGS] ("All this [conflicts of interest] together creates the impression of no culture of accountability."); Alap Shah, *Just How Unusual Are the Related Party Transactions Disclosed in the We Company's S-1 Filing?*, FORBES (Aug. 19, 2019, 1:06 AM EST), https://www.forbes.com/sites/alapshah/2019/08/19/just-how-unusual-are-the-related-party-transactions-disclosed-in-the-we-companys-s-1-filing/?sh=7b9a1cec266a [https://perma.cc/PFX5-QCAY] ("It is fair to say that WE's relationships with its related parties go well above and beyond what we have seen in the other recent high profile initial public offerings.").

[72] *See, e.g.*, Press Release, SEC, SEC Charges the Walt Disney Company for Failing to Disclose Relationships Between Disney and Its Directors (Dec. 20, 2004), https://www.sec.gov/news/press/2004-176.htm [https://perma.cc/9R52-57BM] (quoting Linda Chatman Thomson, then Deputy Director of the SEC's Division of Enforcement's statement that "Shareholders have a significant interest in information regarding relationships between the company and its directors . . . . Failure to comply with the SEC's disclosure rules in this area impedes shareholders' ability to evaluate the objectivity and independence of directors.").

impair effective cooperative interaction between external and internal monitoring in corporate compliance.[73]

Second, the modified definition can also obstruct companies' information acquisition. As external regulations on insider trading and related party transactions have "materiality" standards,[74] whether a stock trade is based on "material" information and whether a related person has "material" interest in a transaction determines the fate of the trading or transaction at issue. Who should apply the materiality standard? When corporate policies modify the definition of prohibited action either stringently or leniently, companies transform standards into rules,[75] shutting down the channel for employees to report their trading or transactions to corporate managers for review.[76] For instance, when an insider trading policy broadly prohibits the trading of any other company's stock, the policy tends to eliminate the review and approval process altogether. As a result, instead of a better informed and more sophisticated corporate manager, each employee must determine whether her information is material.[77] This practice does not effectively

[73] *See* Rory Van Loo, *Regulatory Monitors: Policing Firms in the Compliance Era*, 119 COLUM. L. REV. 369, 400 (2019) ("Depending on how it is implemented, self-regulation can diminish the role of regulatory monitors relative to other agency groups because it privatizes core monitoring tasks.").

[74] In federal securities laws, the materiality standard is satisfied when there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

[75] *See, e.g.*, Executive Compensation and Related Person Disclosure, 71 Fed. Reg. 53157, 53197 (Sept. 8, 2006) (codified at 17 C.F.R. pts. 228-29, 232, 239-40, 245, 249 and 274) ("Today, we are amending Item 404 of Regulation S-K . . . to streamline and modernize this disclosure requirement, while making it more principles-based.").

[76] *See* Jennifer Arlen, *Evolution of Director Oversight Duties and Liability Under* Caremark*: Using Enhanced Information-Acquisition Duties in the Public Interest*, *in* RESEARCH HANDBOOK ON CORPORATE LIABILITY 194, 199 (Martin Petrin & Christian A. Witting eds., 2023) ("[C]hanneling information about misconduct to (independent) directors enhances the likelihood that the firm will self-report detected misconduct and fully cooperate with enforcement authorities as directors are less likely than management to face conflicts of interest.").

[77] *See, e.g.*, Joan MacLeod Heminway, *Just Do It! Specific Rulemaking on Materiality Guidance in Insider Trading*, 72 LA. L. REV. 999, 1013-14 (2012) [hereinafter *Materiality Guidance*] (contending that ambiguity in the materiality standard for insider trading discourages "desirable trading opportunities" out of "an abundance of caution"); Joan

serve the federal agency's regulatory intent to employ a principle-based approach rather than the bright-line rule on the issue.[78]

The rest of the paper is organized as follows. Part I of this Article examines the expanded role and limits of corporate private ordering in corporate compliance. Part II empirically analyzes the terms of real-world corporate policies to show how each company strategically customizes compliance policies in practice. Based on the foregoing empirical analysis and theoretical framework, Part III makes normative suggestions for effective compliance programs, focusing on companies' autonomous implementation and enforcement of corporate policies, rather than additional regulatory interventions. It also offers specific proposals to companies, shareholders, regulators, and prosecutors to ensure the efficacy of corporate policy as a critical part of companies' compliance programs.

I. CORPORATE POLICIES AS A PRIVATE ORDERING MECHANISM

The existence and relevance of internal corporate policies are far from new. Especially in complex corporate organizations, it seems inevitable to have internal policies to facilitate compliance with external rules. While most internal corporate policies and attendant documents are not required to be disclosed to the public, it has become more common for company websites to voluntarily post internal corporate documents on a wide range of subjects under various names, such as policies, guidelines, reports, and statements.[79]

MacLeod Heminway, *Materiality Guidance in the Context of Insider Trading: A Call for Action*, 52 AM. U. L. REV. 1131, 1191 (2003) ("[B]y enhancing certainty and predictability of result, effective materiality guidance may result in fewer insider trading class action settlements, and the value of any settlements should better reflect actual, rather than speculative (or nuisance), measures of value.").

[78] *Cf.* Kayla Kershen, SEC v. Panuwat*: The Federal Pursuit of Shadow Trading*, 17 BROOK. J. CORP. FIN. & COM. L. 151, 154 (2023) ("Together, these provisions "'[] assure that dealing in securities is fair and without undue preferences or advantages among investors.'" (quoting *Chiarella v. United States*, 445 U.S. 222, 241 (1980)). *See generally* Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 559 (1992) (discussing the economics of whether "legal commands should be promulgated as rules or standards").

[79] *See* Nili & Hwang, *supra* note 12, at 1116-18. The conventional wisdom about internal corporate information was that more information might trigger more litigation,

A. Growing Demand for Written Corporate Policies

On specific issues, regulators explicitly require companies to implement corporate policies. The SEC has mandated that public companies disclose "policies and procedures for the review, approval, or ratification" of related party transactions since 2006.[80] In 2022, the SEC added two more issues on which corporate policies should be implemented: insider trading[81] and executive compensation clawbacks.[82] However, companies are facing increasing pressure to adopt and disclose their internal policies beyond those topics with explicit mandates. The pressure comes simultaneously but independently from multiple sources, such as enforcement authorities, shareholders, and the courts. This Section examines recent trends in corporate governance and compliance relevant to corporate policies.

1. DOJ and Enforcement Mitigation

Corporate policies are where corporate governance and compliance closely interact. Such policies are essential governance mechanisms to (formally) allocate authority within a company and control information flow. At the same time, from the corporate compliance standpoint, corporate policies are an essential element of a good corporate compliance program, which is helpful when the company is subject to external investigation.[83] Since the U.S. Sentencing Commission's innovative approach was adopted in the U.S. Organizational Sentencing

and companies tend to preserve information, keeping such information undisclosed to the public, as much as possible. After all, when a dispute arises, the last thing the company wants is for the plaintiff to point to an express statement in a disclosed document and explain how that statement conflicts with the behavior in dispute. Notwithstanding the conventional understanding, many companies voluntarily disclose their internal policies. Testing the multiple hypotheses on why (or under what circumstances) corporations voluntarily disclose their internal policies can be an important empirical question.

[80] 17 C.F.R. § 229.404(b)(1) (2023).

[81] Rule 10b5-1 and Insider Trading, 87 Fed. Reg. 8686, 8695 (proposed Feb. 15, 2022) (codified at 17 C.F.R. pts. 229, 232, 240, 249) (section on disclosure of insider trading policies and procedures).

[82] Listing Standards for Recovery of Erroneously Awarded Compensation, 87 Fed. Reg. 73076, 73119 (Nov. 22, 2022) (codified at 17 C.F.R. pts. 229, 232, 240, 249, 270, 274).

[83] *See* Martinez, *supra* note 22, at 258-60.

Guideline in 1991,[84] various enforcement authorities use an effective compliance program to mitigate the penalty (e.g., potential fine range).[85] This is done to incentivize companies' self-policing and to effectively deter corporate crime.[86] However, what precisely makes a compliance program "good" is not always obvious, and the DOJ published a checklist of items used to evaluate companies' compliance programs,[87] including corporate "policies and procedures":

> Any well-designed compliance program entails policies and procedures that give both content and effect to ethical norms and that address and aim to reduce risks identified by the company as part of its risk assessment process. As a threshold matter, prosecutors should examine whether the company has a code of conduct that sets forth, among other things, the company's commitment to full compliance with relevant Federal laws that is accessible and applicable to all company employees. As a corollary, prosecutors should also assess *whether the company has established policies and procedures that incorporate the culture of compliance into its day-to-day operations.* (emphasis added).[88]

Having maintained an excellent corporate compliance program *before* the violation is quite advantageous when entering into a Deferred

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[84] PAULA DESIO, U.S. SENTENCING COMM'N, AN OVERVIEW OF THE ORGANIZATIONAL GUIDELINES, https://www.ussc.gov/sites/default/files/pdf/training/organizational-guidelines/ORGOVERVIEW.pdf (last visited July 28, 2023) [https://perma.cc/ZGE3-MUXD] (describing guidelines that became effective on Nov. 1, 1991) ("The organizational guidelines . . . do not offer precise details for implementation. This approach was deliberately selected in order to encourage flexibility and independence by organizations in designing programs that are best suited to their particular circumstances.").

[85] *Id.* ("This mitigating credit under the guidelines is contingent upon prompt reporting to the authorities and the non-involvement of high level personnel in the actual offense conduct.").

[86] *See* Veronica Root, *The Compliance Process,* 94 IND. L.J. 203, 214 (2019); Jennifer Arlen, *Corporate Criminal Enforcement in the United States: Using Negotiated Settlements to Turn Potential Corporate Criminals into Corporate Cops* 2 (N.Y.U. Sch. of L. Pub. L. & Legal Theory Rsch. Paper Series, Working Paper No. 17-12, 2018).

[87] *See* EVALUATION OF CORPORATE COMPLIANCE PROGRAMS, *supra* note 13, at 3.

[88] *Id.* at 3-4; *see also infra* Part I.B.

Prosecution Agreement ("DPA") or Non-Prosecution Agreement ("NPA") with the DOJ criminal division.[89] On September 15, 2022, the Deputy Attorney General issued a memorandum reiterating the significance of companies' self-disclosure in the corporate criminal enforcement process.[90] Again, on January 17, 2023, the Assistant Attorney General announced further revisions to the corporate enforcement policy, expanding the scope of more companies to potentially avoid prosecution.[91] This means, in turn, that, to fully gain the newly articulated benefits in the criminal enforcement process, companies must not fail to detect and self-disclose misconduct. For that purpose, corporate policies that enhance information flow will be essential.[92] As such, the DOJ's enforcement policy functions as a driving force for the increased adoption of corporate policies.[93]

[89] *See supra* notes 1–5 and accompanying text. In addition, creating and maintaining a good compliance program is often a mandate in the DPA/NPA *after* corporate wrongdoing is uncovered by the government, and companies can overinvest in compliance programs to offset the stigma of repeat wrongdoers. *See* Jennifer Arlen & Marcel Kahan, *Corporate Governance Regulation Through Nonprosecution*, 84 U. CHI. L. REV. 323, 323 (2017); John Armour, Brandon Garrett, Jeffrey Gordon & Geeyoung Min, *Board Compliance*, 104 MINN. L. REV. 1191, 1199 (2020). Also, the DOJ's guidelines incentivize both well-intentioned and ill-intentioned companies to produce more corporate policies because well-intentioned companies will want to implement the best practices to improve the culture of compliance (intrinsic motivation), even though the probability of having to deal with the DOJ on DPA/NPA is low. On the other hand, ill-intentioned companies will have a strong incentive to implement corporate policies to reduce the level of criminal enforcement (extrinsic motivation).

[90] *See* Miriam H. Baer, *Designing Corporate Leniency Programs*, *in* THE CAMBRIDGE HANDBOOK OF COMPLIANCE, *supra* note 44, at 365, 365; Memorandum from Lisa O. Monaco, *supra* note 4.

[91] *See* Polite, *supra* note 3; Albert B. Stieglitz, Jr., R. Joseph Burby, IV & James Hwang, *White Collar, Government & Internal Investigations Advisory: More Carrot, Less Stick: DOJ Announces Corporate Enforcement Policy Revisions*, ALSTON & BIRD (Jan. 23, 2023), https://www.alston.com/en/insights/publications/2023/01/more-carrot-less-stick [https://perma.cc/83WC-2FPA].

[92] *See infra* Part III.A.

[93] Similarly, other federal agencies also use corporate policies as a mitigating factor for enforcement. On October 20, 2022, the U.S. Department of the Treasury, as chair of the interagency Committee on Foreign Investment in the United States ("CFIUS") issued the Enforcement and Penalty Guidelines for the first time. Pursuant to section 721 of the Defense Production Act of 1950, CFIUS is authorized to review certain transactions involving foreign investments in the U.S. to evaluate the effect of such

2. Shareholder Engagement

Shareholders also press companies to create and refine corporate policies. A shareholder proposal is one of the most accessible ways for shareholders to engage with management.[94] Unlike extraordinarily costly proxy fights over director elections, a shareholder who owns as little as $2,000 of stock for more than three years can submit a shareholder proposal.[95] Shareholders submit proposals to align their values, preferences, and views on various subjects from governance issues to social issues.[96]

Along with the emphasis on environmental, social, and governance ("ESG") issues among shareholders, shareholder proposals are used to ask companies to implement corporate policies to comply with the heightened scrutiny for such issues.[97] Although shareholder proposals are advisory and do not legally bind directors,[98] companies often

transactions on U.S. national security. Upon violation of Section 721 and adjacent regulations, CFIUS is authorized to impose monetary penalties and seek other remedies, and the guidelines expressly indicate whether policies are in place to prevent the conduct, and to what extent "written compliance policies" were communicated and implemented across the entity. *See CFIUS Enforcement and Penalty Guidelines*, U.S. DEP'T OF THE TREASURY, https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius/cfius-enforcement-and-penalty-guidelines (last visited July 29, 2023) [https://perma.cc/UX2U-EL2M].

94 *See* Kobi Kastiel & Yaron Nili, *The Giant Shadow of Corporate Gadflies*, 94 S. CAL. L. REV. 569, 572-573 (2021).

95 17 C.F.R. § 240.14a-8(b) (2023). On September 23, 2020, the SEC amended the eligibility requirement using a tiered approach based on a combination of ownership amount and holding period, which is stricter than the previous rule requiring a $2,000 value of ownership for one year.

96 *See* WELSH & PASSOFF, *supra* note 19, at 5; Fisch, *Purpose Proposals*, *supra* note 20, at 122-23; Tallarita, *supra* note 20, at 1700.

97 *E.g.*, Amazon.com, Inc., Proxy Statement (Form DEF 14A) 23 (May 26, 2021) ("This year, certain of the shareholder proposals relate to environmental, sustainability, social, or governance issues, often requesting that we prepare a report, *adopt a policy*, or take some other particular action." (emphasis added)).

98 With one exception of a shareholder-initiated bylaw amendment proposal. *See* Fisch, *Governance by Contract*, *supra* note 28, at 398 ("Shareholder resolutions seeking to amend the bylaws are typically, albeit not inevitably, presented to the issuer in the form of Rule 14a-8 shareholder proposals."); Brett McDonnell, *Shareholder Bylaws, Shareholder Nominations, and Poison Pills*, 3 BERKELEY BUS. L.J. 205, 258 (2005) ("The main way that shareholders can make legally binding proposals is through bylaw amendments.").

respond to shareholders' requests partly to avoid confrontation with shareholders and to avoid public backlash, which can potentially influence director election.[99]

The next Subsection will discuss how shareholders are increasingly pushing companies to establish effective corporate compliance programs not just by submitting shareholder proposals and voting, but through shareholder litigation based on the fiduciary duty to monitor, commonly referred to as *Caremark* claims.

3. Courts and the *Caremark* Duty

Another relevant change in corporate compliance is the recent Delaware case law development on corporate directors' oversight duty.[100] In 1996, the Delaware Chancery Court first established directors' oversight duty in the seminal case of *In re Caremark International Inc.*,[101] and ten years later, the basic tenets were further clarified in *Stone v. Ritter*.[102] While sound in principle, there were

[99] *See* INSTITUTIONAL S'HOLDER SERVS., UNITED STATES PROXY VOTING GUIDELINES: BENCHMARK POLICY RECOMMENDATIONS 12 (2021), https://www.issgovernance.com/file/policy/2022/americas/US-Voting-Guidelines.pdf [https://perma.cc/3V8C-HJ29] (stating that "the board failed to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year" is a negative factor for director election in the following year); Stephen J. Choi, Jill E. Fisch & Marcel Kahan, *Director Elections and the Role of Proxy Advisors*, 82 S. CAL. L. REV. 649, 664 (2009); Lisa M. Fairfax, *Just Say Yes? The Fiduciary Duty Implications of Directorial Acquiescence*, 106 IOWA L. REV. 1315, 1337 (2021).

[100] *See* John Armour, Jeffrey Gordon & Geeyoung Min, *Taking Compliance Seriously*, 37 YALE. J. ON REGUL. 1, 6 (2020); Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2017 (2019) ("In practice, Delaware courts have prioritized giving directors broad latitude to take business risk by drawing a line at legal risk, despite the possibility that both types of activity could create social value or harm depending on the circumstances."); Roy Shapira, *A New* Caremark *Era: Causes and Consequences*, 98 WASH. U. L. REV. 1857, 1859 (2021); Leo E. Strine, Jr., Kirby M. Smith & Reilly S. Steel, Caremark *and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective* Caremark *and EESG Strategy*, 106 IOWA. L. REV. 1885, 1897 (2021).

[101] *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996).

[102] Stone v. Ritter, 911 A.2d 362, 370 (Del. 2006). At its core, the *Caremark* line of cases imposed certain obligations on the corporate directors regarding their duty of oversight with respect to compliance with external regulations: (1) an obligation to have reasonable oversight system; and (2) an obligation to react when certain bad information (a "red flag") becomes known to the directors.

uncertainties relating to the application and extent of corporate directors' oversight duty along with the boundaries of shareholder plaintiffs' claims.[103] Perhaps consequently, *Caremark* claims have rarely survived a motion to dismiss in Delaware.[104]

However, the Delaware Supreme Court refreshed the directors' oversight duty in *Marchand v. Barnhill* in 2019.[105] In *Marchand*, Blue Bell Creameries ("Blue Bell") had a listeria outbreak that contaminated its ice cream, resulting in three tragic deaths. The Chancery Court dismissed the *Caremark* claim filed against Blue Bell's board of directors, but the Delaware Supreme Court reversed, emphasizing the fact that the Blue Bell board did not even discuss whether or not the listeria outbreak indicated an oversight failure, in breach of its *Caremark* obligations.[106] In the 2021 Delaware Chancery Court's decision on two Boeing 737 Max crashes that killed 346 people, Vice Chancellor Zurn reiterated the *Caremark* two-prong test for directors' oversight duty:[107]

> At the pleading stage, a plaintiff must allege particularized facts that satisfy one of the necessary conditions for director oversight liability articulated in *Caremark*: either that (1) "the directors utterly *failed to implement any reporting or information system or controls*"; or (2) "having implemented such a system or controls, [the directors] consciously *failed to monitor or oversee its operations* thus disabling themselves from being informed of risks or problems requiring their attention." I respectfully refer to these conditions as *Caremark* "prong one" and "prong two."[108]

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[103] Even the *Caremark* court tacitly acknowledged the difficulty of showing directors' failure from the beginning. *In re Caremark*, 698 A.2d at 967 (The directors' oversight duty is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.").

[104] *See* Pollman, *supra* note 100, at 2031 n.91 ("If one looks to jurisdictions outside of Delaware applying the *Caremark* standard, the universe of cases that survived motions to dismiss expands significantly.").

[105] Marchand v. Barnhill, 212 A.3d 805, 809 (Del. 2019).

[106] *Id.* at 817.

[107] *In re* Boeing Co. Derivative Litig., No. 2019-0907, 2021 WL 4059934, at *24 (Del. Ch. Sept. 7, 2021).

[108] *Id.* (emphasis added).

Caremark prong one is about failing to implement a reporting system, and prong two is about ignoring red flags.[109] Whether a company has an information system enabling directors' effective oversight has become a critical issue in the Boeing case. The Court concluded that the plaintiffs successfully carried their burden for their prong one claim based on the fact that the board "did not monitor, discuss, or address airline safety on a regular basis," "had no regular process or protocols requiring management to apprise the board of airplane safety,"[110] and "only received ad hoc management reports that conveyed only favorable or strategic information."[111]

The Boeing case indicates that the prong one of the *Caremark* duty examines whether an information channel on a regular basis, as opposed to an ad hoc one, is in place.[112] *Caremark* prong two evaluates whether directors monitor the operation of the information system and stay informed about the risks.[113] In light of Delaware's further extension of the duty of oversight to corporate officers,[114] the *Caremark* duty can provide corporations with growing incentives to implement stand-alone corporate policies, which are a vital element of good corporate

[109] *Id.*

[110] *Id.* at *27. Plaintiff shifted the focus from *Caremark* prong two to prong one at oral argument.

[111] *Id.* at *28. Furthermore, courts infer directors' scienter from those facts showing the lack of information system (*Caremark* prong one). *See id.* at *32 ("[F]acts that allow[] a reasonable inference that the directors breached their duties of oversight with scienter: not only did the Director Defendants act inconsistently with their fiduciary duties, but they also knew of their shortcomings.").

[112] *Id.* at *32-33.

[113] *See* Roy Shapira, *Max Oversight Duties: How* Boeing *Signifies a Shift in Corporate Law*, 48 J. CORP. L. 119, 129 (2022) ("[D]efendants in *Caremark* litigation could historically get off by showing *any* type of compliance efforts. Some compliance was enough compliance. *Boeing* shows that this is clearly not the case today. . . . Boeing's board minutes invoked 'safety' several times, yet the court criticized them for doing this only in passing and in the context of getting on the regulator's good side. . . . All in all, *Boeing* shows just how much courts are willing to scrutinize what directors should have known and how they should have reacted.").

[114] *See In re* McDonald's Corp. S'holder Litig., 289 A.2d 343, 350 (Del. Ch. 2023).

compliance systems, functioning as a roadmap for information flow within the company.[115]

B. Customization of Corporate Policies

In most cases, the adoption and disclosure of a stand-alone corporate policy are not legally required, with a few exceptions, including corporate charters,[116] bylaws,[117] committee charters,[118] corporate governance guidelines,[119] and codes of ethics.[120] When companies choose to adopt and disclose a stand-alone corporate policy, they normally post the policy in something akin to a "Corporate Governance Documents" section under the "Investor Relations" tab on their websites, but they rarely file these policies with the SEC. Since many companies opt not to

[115] *See* Arlen, *supra* note 76, at 212 (referring to these "enhanced and specific information-acquisition duties" in the new wave of *Caremark* cases as "*Caremark* 2.0" duties.).

[116] 17 C.F.R. § 229.601(b)(3)(i) (2023).

[117] *Id.* § 229.601(b)(3)(ii).

[118] Major U.S. stock exchanges mandate the adoption and disclosure of written committee charters for certain committees. *E.g.*, NASDAQ LISTING RULES, *supra* note 56, § 5605(c)(1) (audit committee charter), § 5605(d)(1) (compensation committee charter); NYSE LISTED COMPANY MANUAL, *supra* note 56, § 303A.04(b) (nominating/corporate governance committee charter), § 303A.05(b) (compensation committee charter); *id.* § 303A.07(b) (audit committee charter).

[119] NYSE LISTED COMPANY MANUAL, *supra* note 56, § 303A.9 (corporate governance guidelines) ("Listed companies must adopt and disclose corporate governance guidelines."). Nasdaq, however, does not require corporate governance guidelines. *See* WEIL PUB. CO. ADVISORY GRP., REQUIREMENTS FOR PUBLIC COMPANY BOARDS: INCLUDING IPO TRANSITION RULES 26 (Jan. 3, 2022), https://governance.weil.com/wp-content/uploads/2022/01/Requirements-for-Public-Company-Boards-Including-IPO-Transition-Rules.pdf [https://perma.cc/MX28-XH99].

[120] The SEC rule on code of ethics is based on a "comply or explain" approach. Code of Ethics, 17 C.F.R. §229.406(a) (2023); *Codes of Ethics: SEC Requirements*, WORDS OF WISDOM FROM LATHAM & WATKINS, https://wowlw.com/Article/Index/153 (last updated Jan. 1, 2017) [https://perma.cc/J92T-HXHT] (Regulation S-K Item 406 "requires a company to disclose whether it has adopted a code of ethics. . . . If the company has not adopted a code of a ethics, it must explain why not"). But major stock exchanges mandate the adoption and disclosure of code of ethics, with a slight variation in titles. *See, e.g.*, NASDAQ LISTING RULES, *supra* note 56, § 5610 (code of conduct); NYSE LISTED COMPANY MANUAL, *supra* note 56, § 303A.10 (code of business conduct and ethics).

disclose them for a variety of reasons,[121] corporate policies disclosed by companies to the public are only a subset of the entire corpus of existing corporate policies. Even so, disclosed, stand-alone corporate policies are informative resources that provide insight into companies' internal decision-making process on important issues.[122]

Shareholders do not have any procedural rights over corporate policies, and corporate managers have the authority to select topics and design the terms of corporate policies.[123] Unlike corporate charters and bylaws,[124] managers can unilaterally adopt, modify, or remove corporate policies at any time without disclosing those actions.[125] Furthermore, while state corporate law imposes some substantive requirements on charters and bylaws, each company's latitude over the contents of corporate policies seems almost unbounded. The subject of each document ranges from general business conduct to specific issues, such as anti-corruption and human rights,[126] and specific terms of corporate policies are likely to be protected under the business judgment rule.[127]

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[121] *See* Andrew K. Jennings, *Disclosure Procedure*, 82 MD. L. REV. 920, 958-60 (2023); Nili & Hwang, *supra* note 12, at 1119 ("The rationales behind those disclosures, however, may vary. Some companies may have conduct policies but choose not to disclose them."); Hillary A. Sale, *Disclosure's Purpose*, 107 GEO. L.J. 1045, 1047 (2019).

[122] For data description of corporate policies used in this Article, *see infra* notes 129–31 and accompanying text.

[123] *See* Afsharipour, *supra* note 24, at 372.

[124] *E.g.*, DEL. CODE ANN. tit. 8, § 242 (2023) (charter amendment); *id.* § 109 (2023) (bylaw amendment).

[125] One exception other than corporate charters and bylaws is the code of ethics. Companies are free to amend their code of ethics, but they must disclose the amendments under Item 5.05 of Form 8-K (Current Report). Code of Ethics, 17 C.F.R. § 229.406(d) (2023).

[126] For instance, Apple's website discloses ten governance documents along with its corporate charters and bylaws. *Leadership and Governance*, APPLE, https://investor.apple.com/leadership-and-governance/default.aspx (last visited July 21, 2023) [https://perma.cc/A4S9-2U9D]. Those corporate policies include, an anti-corruption policy, an antitrust and competition law statement, a business conduct policy, corporate governance guidelines, director conflict of interest guidelines, a human rights policy, a related party transaction policy, and stock ownership guidelines.

[127] Establishing corporate policies for a day-to-day operation falls within the business judgment rule. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("[The business judgement rule] is a presumption that in making a business decision the

Ultimately, companies have wide discretion regarding policy creation, content, and modification.

Although the distinction between corporate governance and corporate compliance is not clear anymore,[128] corporate governance primarily involves the allocation of power among corporate constituents,[129] and rules on corporate governance are largely enabling.[130] Many corporate *governance* choices are made according to each company's particular circumstances, and such customization rarely violates relevant laws and regulations.[131] Regulatory *compliance*, by contrast, deals with internal control to meet predominantly *mandatory* rules set by external authorities (e.g., federal securities laws and stock exchange listing rules), which does not leave as much room for customization to individual corporations.[132] The extent of discretion that corporate managers currently have, and should have, when customizing regulatory compliance through corporate policies is a critical yet underappreciated area of focus in the literature.

II. CORPORATE POLICIES IN ACTION

This Article focuses on two different types of corporate policies that relate to core issues in corporate law and securities regulation: insider

directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.").

[128] *See* Griffith, *supra* note 1, at 2078; Symposium, *The Changing Face of Corporate Compliance and Corporate Governance*, 21 FORDHAM J. CORP. & FIN. L. 1, 8 (2016) ("Monitoring and overseeing the internal affairs of the organization is what compliance does, and that is a core corporate governance function.").

[129] *See* Lund & Pollman, *supra* note 24, at 2596.

[130] *See* Ayres, *supra* note 28, at 6; Black, *supra* note 28, at 544; Easterbrook & Fischel, *supra* note 28, at 1420. On a more recent debate regarding the private ordering of corporate governance arrangements, see Barzuza, *supra* note 28, at 138-41; Fisch, *Governance by Contract*, *supra* note 28, at 398, 400-03; Lund, *supra* note 28, at 857-58; Lund & Pollman, *supra* note 24, at 2620-22; Kastiel & Nili, *supra* note 28, at 800-02.

[131] For example, some companies implement dual-class stock structures while others do not, but neither group of companies violate any laws simply by making different choices.

[132] Despite the foundational differences, corporate governance and corporate compliance increasingly influence each other. *See* Baer, *supra* note 16, at 952; Griffith, *supra* note 1, at 2078.

trading policies and related party transaction policies. As of August 2022, fifty-one insider trading policies, and 101 related party transaction policies were available on the S&P 500 companies' websites.[133] Detailed terms in the 152 corporate policies were manually downloaded, collected, and coded.[134] The main empirical contribution of this Article is the in-depth analysis of original data on related party transactions and insider trading policies.[135] As the first analysis of *stand-alone* corporate policies on both related party transactions and insider trading, this Article provides a comprehensive analysis of internal processes. It will complement and update findings in prior literature on those corporate policies, which also include summarized versions of the policies rather than stand-alone corporate policies.[136]

Approximately eighty percent of the policies in the sample include specific dates of adoption, meaning that twenty percent of them provided no information about when their current policies were drafted or amended.[137] The SEC adopted its requirements concerning related party transaction policies and procedures in August 2006, and three companies, Whirlpool Corp.,[138] Travelers Companies,[139] and Globe Life Inc.,[140] still use their policies updated in late 2006. As shown in Figure 1

[133] As companies can change the contents of their websites without a trace, all websites were visited within a week (Oct. 23–27, 2022) for consistency.

[134] All 152 policies used for this article are on file with the author.

[135] *See infra* Parts II.A.2–3, II.B.2–3.

[136] *See, e.g.*, Mihir N. Mehta, David Reeb & Wanli Zhao, *Shadow Trading*, 96 ACCT. REV. 367 (2021) (collecting "each source firm's Code of Ethics statement or Employee Professional Conduct manual to determine the source firm's insider trading policy"); Tuch, *supra* note 61, at 995-98 (analyzing 100 randomly selected Delaware companies' related party transaction policies disclosed in their *proxy statements* to document the variance in approving entities for related party transactions).

[137] Approximately 76% (39 out of 51) sample insider trading policies and 81% (82 out of 101) sample related party transaction policies had their effective dates provided. *See infra* Appendix.

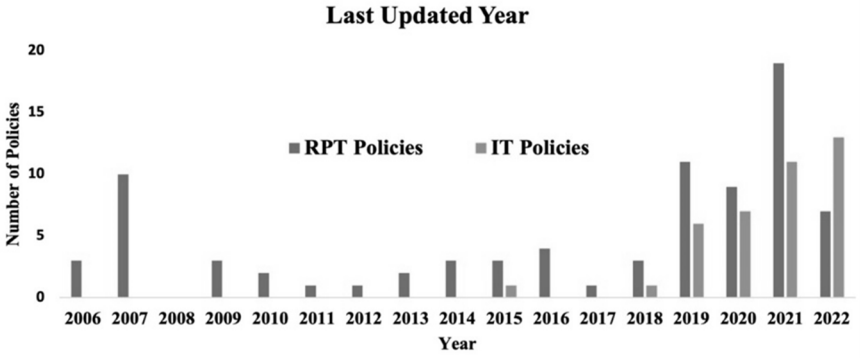
[138] *Code of Ethics: Procedures for Evaluating Related Person Transactions*, WHIRLPOOL CORP. (Dec. 19, 2006), https://www.whirlpoolcorp.com/procedures-for-evaluating-related-person-transactions/ [https://perma.cc/K42N-5VLY].

[139] TRAVELERS COMPANIES, RELATED PARTY RELATED PERSON TRANSACTION POLICY (adopted December 13, 2006) (on file with the author).

[140] GLOBE LIFE INS. INVS., STATEMENT OF POLICY WITH RESPECT TO RELATED PARTY TRANSACTIONS (2006), https://investors.globelifeinsurance.com/MediaLibraries/

below, in 2007, there was a spike in fulfillment of the new requirements.[141] Amendment or implementation of related party transaction policies slowed until a renewed upward trend began in about 2014, which coincided with shareholder engagement in voting empowered by proxy advisors.[142]

Figure 1. Frequency of Related Party Transactions Policies and Insider Trading Policies' Latest Amendments Per Year



A. Strict Internal Control: Insider Trading Policies

This Section discusses how companies customize their internal rules on insider trading and how those corporate policies interact with the external regulatory regime. As of August 2022, fifty-one S&P 500 component companies have disclosed their stand-alone insider trading policies on their company websites.[143] The policies show common trends across companies, but they are far from mere boilerplates.[144]

This Article contributes to the prior literature on insider trading policies by providing the first analysis of the "boundary of insider

GlobeLifeInvestorRelations/pdfs/RELATED-PARTY-POLICY-Ed-Oct2006.pdf [https://perma.cc/MS33-F5JD].

[141] *See infra* Figure 1.

[142] *See* Lund & Pollman, *supra* note 24, at 2596 ("Many companies proactively adopt governance policies that mesh with ISS and Glass Lewis recommendations."); Min, *Shareholder Voice in Corporate Charter Amendments*, *supra* note 28, at 312.

[143] *See infra* Appendix.

[144] *See infra* Table 1.

trading"[145] expressed in "stand-alone" insider trading policies,[146] which is the best source available because it provides the most comprehensive and accurate depiction of how companies self-regulate insider trading.[147]

1. External Regulations on Insider Trading

This Subsection will explain (1) what is prohibited as insider trading and (2) what would be the legal consequences of an insider trading violation under the current regulatory regime. The purpose of this brief introduction is not to evaluate the regulations but to lay down the groundwork for comparing corporate policies with the regulations.

[145] Prior studies on stand-alone insider trading policies specifically focused on the 10b5-1 Plan, which only applies to the trading of the employer's stock and does not extend to the trading of other companies' stock. *See* Anderson, *supra* note 44, at 296; Bainbridge, *supra* note 44, at 864; Chasin, *supra* note 44, at 867; Jagolinzer et al., *supra* note 35, at 1251.

[146] A recent study on insider trading policies relies on a description from a general ethics policy (e.g., Code of Ethics), rather than a stand-alone insider trading policy. *See* Mehta et al., *supra* note 136, at 393.

[147] As the SEC acknowledges, there is a noticeable informational gap between stand-alone insider trading policies and an insider trading policy described in the codes of ethics. Rule 10b5-1 and Insider Trading, 87 Fed. Reg. 8686, 8693 (proposed Feb. 15, 2022) (codified in 17 C.F.R. pts. 229, 232, 240, 249) ("While codes of ethics may address insider trading issues, they often lack the detail necessary for investors to assess actual practices surrounding potential insider trading. Accordingly, we are proposing new Item 408 under Regulation S-K . . . to require . . . (2) annual disclosure of a registrant's insider trading policies and procedures."). The proposed rule, however, also says that cross-referencing code of ethics will suffice the new requirement, which may discourage the disclosure of stand-alone policies. *Id.* at 8695 ("We also recognize that registrant's existing code of ethics may contain insider trading policies. In this case, the registrant, could cross-reference to the particular components of its code of ethics that constitute insider trading policies and procedures in response to proposed Item 408 (b)(2)."). In the final rule adopted on December 14, 2022, the SEC addressed the issue. ("*If all of the registrant's insider trading policies and procedures are included in its code of ethics* . . .and . . .is filed as an exhibit pursuant to Item 406(c)(1), a hyperlink to that exhibit, accompanying the issuer's disclosure as to whether it has insider trading policies and procedures, would satisfy this component of the exhibit filing requirement.") (emphasis added). *See* Insider Trading Arrangements and Related Disclosures, 87 Fed. Reg. 80362, 80385 (Dec. 29, 2022) (codified at 17 C.F.R. pts. 229, 232, 240, 249).

a. The Boundary of Illegal Insider Trading

Insider trading — selling or purchasing securities using material, nonpublic information[148] — is unlawful under SEC Rule 10b-5,[149] a general anti-fraud provision.[150] Insider trading is strictly prohibited under federal law,[151] but what exactly constitutes insider trading is unclear since neither Congress nor the SEC have expressly defined it.[152] The boundary of illegal insider trading has mainly evolved through court cases.[153] Currently, there are two theories for insider trading liability: classical theory and misappropriation theory.[154] The classical theory prohibits corporate *insiders* from trading using material nonpublic information in breach of the fiduciary duty owed to the employer and its shareholders.[155] The misappropriation theory, on the other hand, extends the boundary further to prohibit corporate outsiders from

[148] *See, e.g.*, Park, *supra* note 39, at 1179 (discussing the prominent theories of insider trading regulation).

[149] Employment of manipulative and deceptive devices, 17 C.F.R. § 240.10b-5 (2023). This rule was adopted pursuant to Section 10(b) of the Securities Exchange Act of 1934. 15 U.S.C. § 78(j)(b). *See* Fried, *supra* note 40, at 808.

[150] *See supra* note 40.

[151] *See* Insider Trading Arrangements and Related Disclosures, 87 Fed. Reg. 80362.

[152] *See* Fisch, *Constructive Ambiguity*, *supra* note 41, at 757-78; Park, *supra* note 39, at 1179; Verstein, *supra* note 41, at 739. Future statutory clarity regarding insider trading may occur with the potential enactment of the Insider Trading Prohibition Act of 2021, which was passed by the House of Representatives in 2021 and attempts to codify relevant case law, but it is still waiting for Senate approval. *See* Insider Trading Prohibition Act, H.R. 2655, 117th Cong. (2021); *cf.* Stephen M. Bainbridge, *A Critique of the Insider Trading Prohibition Act of 2021*, 2021 U. ILL. L. REV. ONLINE 231 (2021) (arguing that the Act would expand liability and make markets less efficient).

[153] *See* Merritt B. Fox, Lawrence R. Glosten & Gabriel V. Rauterberg, *Informed Trading and Its Regulation*, 43 J. CORP. L. 817, 861-68 (2018).

[154] *See* A. C. Pritchard, *Insider Trading Law and the Ambiguous Quest for Edge*, 116 MICH. L. REV. 945, 947-48 (2018) (book review).

[155] Chiarella v. United States, 445 U.S. 222, 227 (1980); *see* Donald C. Langevoort, *Insider Trading and the Fiduciary Principle: A Post-*Chiarella *Restatement*, 70 CALIF. L. REV. 1, 3 (1982) ("*Chiarella* has made the fiduciary principle a consideration of utmost importance.").

trading based on material nonpublic information obtained in violation of a fiduciary duty owed to the source of information.[156]

b. Regulatory Sanctions Against Illegal Insider Trading

A company should be vigilant to prevent illegal insider trading activities by its employees because it can potentially be liable for such activities as a controlling person.[157] The Insider Trading and Securities Fraud Enforcement Act defines "a controlling person" as a natural or non-natural person "who, at the time of the violation, directly or indirectly controlled the person who committed such violation."[158] A controlling person, via stock ownership, agency relationships, or otherwise, can be held jointly and severally liable to the same extent as the person who conducted the insider trading, "unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action."[159] The Exchange Act specifically identifies officers, directors, stockholders, employees, or agents of issuers as individuals who can be punished for violations,[160] and corporations can be fined for willful violations.[161] Thus, the potential for liability being placed on the corporation and other individuals in the corporation besides the primary culprit of insider

[156] United States v. O'Hagan, 521 U.S. 642, 653 (1997); *see also* Colin J. Diamond, Maia Gez, Michelle Rutta, Tami Stark, Danielle Herrick & Scott Levi, *SEC Extends the Misappropriation Theory of Insider Trading Beyond Targets of Acquisitions to Companies "Economically Linked" to Such Targets*, WHITE & CASE (Sep. 9, 2021), https://www.whitecase.com/insight-alert/sec-extends-misappropriation-theory-insider-trading-beyond-targets-acquisitions [https://perma.cc/WS75-8Q7X].

[157] *See, e.g.*, A.C. Pritchard & Robert B. Thompson, *Texas Gulf Sulphur and the Genesis of Corporate Liability Under Rule 10b-5*, 71 SMU L. REV. 927 (2018) (discussing the establishment of a remedy against corporations for the misstatements of its officers and employees); Ari B. Lanin & Daniela L. Stolman, *Building a Better Insider Trading Compliance Program*, 25 INSIGHTS, Mar. 2011, at 1, https://www.gibsondunn.com/wp-content/uploads/documents/publications/Lanin-Stolman-BuildingaBetterInsider TradingComplianceProgram.pdf [https://perma.cc/APC7-XWDH] (exploring how to strengthen insider trading compliance programs to minimize exposure to liability).

[158] Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, § 3, 102 Stat. 4677, 4678 (1988).

[159] 15 U.S.C. § 78t.

[160] *Id.* § 78ff(c).

[161] *Id.* § 78ff(a).

trading inherently induces companies to implement their own compliance policies.

Furthermore, violation of federal insider trading rules triggers both civil sanctions and criminal penalties. For example, civil sanctions can be applied to controlling persons, and these penalties can be as severe as one million dollars or treble damages, whichever is greater.[162] Criminal penalties under the Exchange Act allow for an individual to be fined up to five million dollars and a maximum prison term of twenty years.[163] Corporations can be fined as much as twenty-five million dollars for certain willful violations of the Act.[164] Moreover, the Sarbanes-Oxley Act allows someone guilty of a securities fraud offense to be imprisoned for up to twenty-five years.[165]

Sample insider trading policies show that corporations are keenly aware of the liability and punishments that come with insider trading. For instance, UDR, Inc.'s insider trading policy highlights the relevant insider trading legislation and warns that the "controlling person" can be held liable if the controlling person "knew or recklessly disregarded that an employee (not just a corporate insider) was likely to engage in insider trading and failed to take action to prevent violations" under the Insider Trading and Securities Fraud Enforcement Act of 1988.[166] UDR's policy also warns that the legislation has provided the "SEC with potent weapons to enforce federal securities laws."[167] For example, MGM's insider trading policy emphasizes that an employee may face severe criminal and civil penalties for illegal insider trading, including up to twenty years of imprisonment.[168] The policy also calls out that a

[162] Insider Trading and Securities Fraud Enforcement Act of 1988 § 3.

[163] 15 U.S.C. § 78ff(a).

[164] *Id.*

[165] 18 U.S.C. § 1348.

[166] UDR, INC., AMENDED AND RESTATED INSIDER TRADING COMPLIANCE PROGRAM 1 (2023), https://s27.q4cdn.com/542031646/files/doc_downloads/governance_docs/2023/insider-trading-compliance-program-2-9-23.pdf [https://perma.cc/SQ8V-HVV9].

[167] *Id.*

[168] MGM RESORTS INT'L, MGM SECURITIES TRADING POLICY 2 (2019))), https://s22.q4cdn.com/513010314/files/doc_downloads/gov_doc/08/MGM-Securities-Trading-Policy-(Final-2019).pdf [https://perma.cc/EMK6-YX4X]) ("Individuals found to have engaged in insider trading may face up to 20 years in prison and severe fines,

controlling person can be held liable if they "fail to take reasonable steps to prevent insider trading."[169] Elevance Health's policy warns that the SEC and U.S. Attorney's Office pursue insider trading "vigorously," and that those found guilty of insider trading are "punished severely," as well as warning that the company can be found liable as a controlling person.[170] Campbell's Soup's insider trading policy also warns of "substantial penalties" for violators, explaining the criminal and civil punishments that await a guilty party.[171] Given that the severity of penalties is commonly discussed in insider trading policies but scarcely in related party transactions, the concern of heavy penalties paired with the concept that controlling persons can hold companies liable for potential inaction appears to influence, if not spur, insider trading policies.

2. Boundary Customization: Expansion by Categorical Inclusion

Insider trading is illegal, but what exactly is insider trading? Insider trading differs from trading by insiders, since not all trading by insiders is illegal under federal law.[172] Under federal law, trading "stock" based on material nonpublic information is prohibited, but as shown in Table 1 below, the sample companies employ three distinct definitions for which company's stock is subject to the trading prohibition.[173] The narrowest one is to prohibit trading of (1) employer's stock using material nonpublic information, which is prohibited in all companies.[174]

including criminal penalties of up to $5,000,000 and additional civil fines of up to three times the profit gained or loss avoided, in addition to disgorgement.").

[169] *Id.* ("Law enforcement authorities may also impose insider trading liability on companies, including criminal fines of up to $25,000,000. There is also the possibility of additional civil monetary penalties for 'controlling persons' . . . .").

[170] ELEVANCE HEALTH, INSIDER TRADING POLICY 1 (2022), https://s202.q4cdn.com/665319960/files/doc_governance/Insider_Trading_Policy-_FINAL_Edited_6_28_2022.pdf [https://perma.cc/M33E-HUCE].

[171] CAMPBELL SOUP CO., INSIDER TRADING POLICY 1-2 (2019) (on file with the author).

[172] *See infra* Part II.B.1.

[173] *See infra* Appendix.

[174] *E.g.*, UDR, INC., *supra* note 166, at A-1 to A-2 ("This prohibition also applies to information about, and the securities of, other companies with which the Company does business, or with which the Company is involved in a potential transaction or business

But in private ordering, companies stretch the prohibition: some companies prohibit trading of (2) business partners' and competitors' stock, and others go even further by prohibiting trading of (3) *any other* companies' stock.[175]

Table 1. Level of Restriction in Insider Trading Policies

Scope of Trading Prohibition	Level of Customization	Number (and %) of Companies
employer's stock	0	2 (3.9%)
employer's stock **and** its business partners' and competitors' stock	0.5	12 (23.5%)
any other company's stock	1	37 (72.5%)

Only two publicly available stand-alone insider trading policies adopt the narrowest definition limited to an employer's stock.[176] Twenty-two percent (11 out of 51) of the policies prevent employees from trading securities of their business partners (e.g., customers or suppliers) and competitors,[177] and seventy-six percent (39 out of 51) of the sample policies go even further to prohibit the trading of *any other* company's stock based on material, nonpublic information.[178] In sum, the data show

relationship, through which a Covered Person may acquire material non-public information of that company.").

[175] *E.g.*, CF INDUS. HOLDINGS, INC., POLICY ON INSIDER TRAINING 1 (2018) ("This prohibition applies not only to our securities, but also to the securities of any other company about which you acquire inside information in the course of your duties for the Company.").

[176] J.B. Hunt's insider trading policy is the only example that adopts the narrowest prohibition. *See* J.B. HUNT TRANSPORT SERVS., INC., INSIDER TRADING POLICY 2 (2022), https://s29.q4cdn.com/385837051/files/doc_downloads/gov_docs/JBHT-Insider-Trading-Policy-Approved.012022.pdf [https://perma.cc/HLG3-L6S9].

[177] Professors Mehta, Reeb, and Zhao coined the term "shadow trading" to refer to trading in two types of "economically-linked" companies — business partners and competitors — using material nonpublic information. Mehta et al., *supra* note 136, at 31-32 (using 267 firms' insider trading policies from the firms' *Codes of Ethics* statement or Employee Professional Conduct manual coded in 2010 and 2011).

[178] *See infra* Appendix.

a strong trend among companies that appear to make their insider trading policies stricter than external regulations.[179]

Since the number of available stand-alone policies covers a small portion of the S&P 500 companies, this Article also analyzes insider trading sections in each company's Code of Ethics to ascertain whether the trend is salient in all sample companies.[180] As Table 2 below shows, the majority (fifty-two percent) of the sample companies' Codes of Ethics prohibit the trading of any other company's stock.[181]

Table 2. Level of Insider Trading Restriction in the Codes of Ethics

Boundary of Trading Prohibition	**Level of Customization**	**Number (and %) of Companies**
Employer's stock only	0	66 (13.2%)
Employer's stock **and** its business partners' and competitors' stock	0.5	55 (11.0%)
Any other company's stock	1	259 (51.8%)
Vague	-	101 (20.2%)
No mention of insider trading	-	19 (3.8%)

In addition to the three levels of trading prohibitions introduced in Table 1, there is another group of companies that do not specify the

[179] For a detailed discussion on why customized corporate policies are more stringent than federal insider trading law, see *infra* Part II.A.4.

[180] The SEC rule on code of ethics is based on a "comply or explain" approach. 17 C.F.R. § 229.406 (2023). But major stock exchanges mandate the adoption and disclosure of codes of ethics. *See, e.g.*, NASDAQ LISTING RULES, *supra* note 56, § 5610 (code of conduct); NYSE LISTED COMPANY MANUAL, *supra* note 56, § 303A.10 (code of business conduct and ethics).

[181] I use the term code of ethics to include other variations, including code of conduct and code of business ethics. Major U.S. stock exchanges mandate listed companies to post the codes of ethics on their websites, and approximately 96% of companies' Codes of Ethics have a section on insider trading, typically summarized in one or two paragraphs at an abstract level. *See* Rule 10b5-1 and Insider Trading, 87 Fed. Reg. 8686, 8693 (proposed Feb. 15, 2022) (codified at 17 C.F.R. pts. 229, 232, 240, 249) ("While codes of ethics may address insider trading issues, they often lack the detail necessary for investors to assess actual practices surrounding potential insider trading.").

boundary of insider trading by using the vague terms [182] as opposed to trading "the Company's stock" or trading "other company's stock." They refer to stand-alone insider trading policies for more details, but only employers can access the policies.[183] Thus, the vague description of insider trading policy in the code of ethics conceals meaningful information from investors without expressly violating the disclosure requirement.

The effective date of corporate codes of ethics is often absent, as is the case with other corporate policies. About 75.2% (376 out of 500) of codes of ethics indicate the date of the latest revision, ranging from 2007 to 2022.[184] Although it is not easy to tell whether the latest revision was made on the insider trading portion, Figure 2 below shows that the ratio of the expansive insider trading prohibition is on the rise. In 2021, one hundred (100) codes of ethics were updated, and fifty-eight percent of them prohibit the trading of any other company's stock.[185]

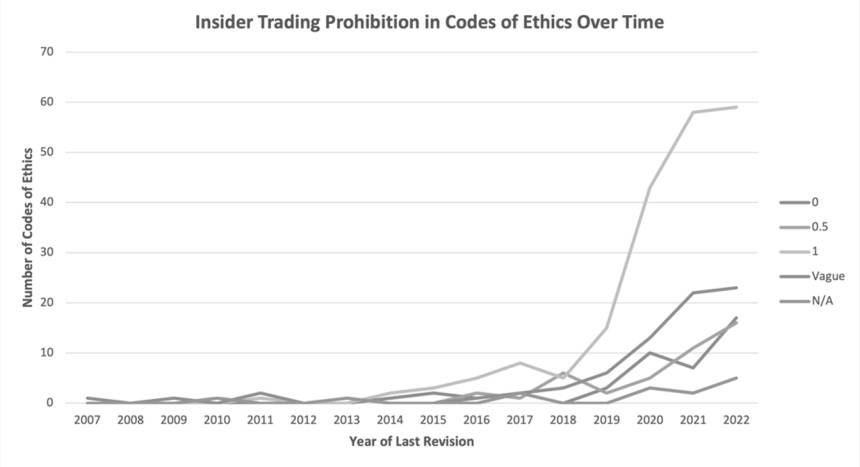
[182] *See, e.g.*, THE HERSHEY CO., CODE OF CONDUCT 20 (2017), https://investors.thehersheycompany.com/content/dam/hershey-corporate/documents/investors/code-of-conduct-english.pdf [https://perma.cc/RM9X-FG5E] ("Don't trade on material inside information . . . ."); VERISK ANALYTICS, INC., CODE OF BUSINESS CONDUCT AND ETHICS 1 (2022), https://s29.q4cdn.com/767340216/files/doc_downloads/gov_docs/Verisk-Code-of-Business-Conduct-and-Ethics.pdf [https://perma.cc/3BEU-WJLR] ("Using non-public Company information to trade in securities . . . is illegal.").

[183] *See, e.g.*, META, KEEP BUILDING BETTER: THE META CODE OF CONDUCT 45 (2022), https://s21.q4cdn.com/399680738/files/doc_downloads/governance_documents/2022/09/new/Meta-Code-of-Conduct-(1).pdf [https://perma.cc/HYC9-LZT8] (asking employees to review the company's Insider Trading Policy on the internal "People Portal" before trading).

[184] These sources are on file with the author.

[185] These sources are on file with the author.

Figure 2. The Trend of Insider Trading Prohibition in the Code of Ethics



3. Procedural Customization: Approval of Pre-Arranged Trading

In 2002, the SEC adopted Rule 10b5-1(c) in an effort to balance equity-based managerial incentives and deterrence of illegal insider trading.[186] The rule allows executives and directors to use a pre-arranged written plan (10b5-1 Plan) as an affirmative defense against illegal insider trading allegations if their stock trading was in accordance with the plan.[187] The SEC rule does not require "pre-approval" of the 10b5-1 plan.[188] Yet, all but five stand-alone insider trading policies require pre-

[186] *See* Merritt B. Fox, *Insider Trading Deterrence Versus Managerial Incentives: A Unified Theory of Section 16(b)*, 92 MICH. L. REV. 2088, 2096 (1994).

[187] 17 C.F.R. § 240.10b5-1(c) (2023).

[188] In December 2022, the SEC significantly amended Rule 10b5-1 in response to increasing concerns about the 10b5-1 Plans, but pre-approval of 10b5-1 is still not required. *See* Insider Trading Arrangements and Related Disclosures, 87 Fed. Reg. 80362 (Dec. 29, 2022) (codified at 17 C.F.R. pts. 229, 232, 240, 249); Jonathan Weil, *New SEC Rules Target Corporate Insider Trading*, WALL ST. J. (Feb. 13, 2023, 11:35 AM EST), https://www.wsj.com/articles/new-sec-rules-target-corporate-insider-trading-4f1c64e8 [https://perma.cc/25W5-M5AN] ("A new [SEC] rule promises to remove many of the loopholes that allowed corporate insiders to hide behind these trading plans.").

approval requirements, making their procedural scrutiny stricter than the federal rule.[189]

As Table 3 below indicates, seventy percent of the sample policies have the most expansive categorical inclusion, combined with pre-approval requirements for 10b5-1 Plans. This reveals companies' strong tendency to customize both procedures and definitional boundaries of their insider trading policies in a way that is more restrictive than the base SEC rule.[190]

[189] Two insider trading policies from A.O. Smith Corporation and Humana Inc. do not address 10b5-1 Plans at all. Three insider trading policies include discussions about 10b5-1 Plans, but they do not clearly specify if a pre-approval is required to make the plan valid. Stryker Corp.'s policy does not mention any process; Trimble Inc.'s policy states that the plan must be "reviewed" by the Insider Trading Compliance Officer; and Hunt J.B. Transport Services Inc.'s policy just indicates that the plan holder should "contact" the office of the Chief Financial Officer ("CFO").

[190] A pre-approval requirement is not the only way to make corporate policies procedurally stricter. *See* Beny & Anand, *supra* note 35, at 250; David F. Larcker, Bradford Lynch, Phillip Quinn, Brian Tayan & Daniel J. Taylor, *Gaming the System: Three "Red Flags" of Potential 10b5-1 Abuse*, STAN. CLOSER LOOK SERIES, Jan. 19, 2021, at 1, 3 (identifying three red flags of opportunistic 10b5-1 plans: "1) short cooling-off periods, 2) single-trade plans that cover a single block trade instead of spacing multiple trades over time, and 3) plans that are adopted and commence trading immediately prior to the next earnings announcements").

Table 3. The Frequency of Customization Per Type

Boundary of Trading Prohibition / **10b5-1 Plan Pre-approval**	**Employer's stock only**	**Employer's and its business partners' and competitors' stock**	**Any other company's stock**	**Total**
Pre-approval requirement	1	10	34	45 (88.2%)
No mention of pre-approval requirement	1	2	3	6 (11.8%)
Total	2 (3.9%)	12 (23.5%)	37 (72.5%)	51 (100%)

4. Implications for External Regulations

The question becomes, how do these expansive insider trading policies fit into the existing insider trading regulation framework? In light of a new case where a federal district court recognized using material, nonpublic information ("MNPI") about one company to trade the stock of another company as insider trading,[191] the sample companies' strong tendency to expand the scope of prohibition further than federal law is noteworthy because a corporate policy that prohibits such trading now has massive legal implications.

On January 14, 2022, the United States District Court for the Northern District of California denied a motion to dismiss an insider trading charge by referring to a company's insider trading policy with an expanded definition, which prohibits employees from trading the securities of "another publicly traded company" using material, nonpublic information.[192] The SEC's allegation was that the defendant's

[191] *See* SEC v. Panuwat, No. 21-cv-06322, 2022 WL 633306, at *3-5 (N.D. Cal. Jan. 14, 2022).

[192] *Id.* at *1.

(Mr. Panuwat's) use of inside information — that Pfizer would acquire his employer (Medivation) — to buy stock of a "comparable" mid-sized biopharmaceutical company (Incyte) constituted a Rule 10b-5 violation.[193] As Mr. Panuwat expected, the stock price of Incyte, as a potential target, surged by about eight percent after the announcement of the Pfizer-Medivation acquisition deal.[194] The court ruled that his trading fell under the SEC's "misappropriation theory" of insider trading, particularly because Mr. Panuwat breached the fiduciary duty to his employer (Medivation) by not complying with the employer's insider trading policy.[195] Thus, this case shows how a company can customize the definition of noncompliance through an internal corporate policy[196] and how that, in turn, can influence external regulators, the courts, and other companies.[197]

The district court's interpretation in *Panuwat*, however, may conflict with Supreme Court precedent on insider trading.[198] As Figure 3 below

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[193] *Id.*

[194] *Id.* at *5.

[195] *Id.* at *8-9; *see* Ayres & Bankman, *supra* note 49, at 239 (noting that under the misappropriation theory, "[a]n employee is a fiduciary of her employer. If a company explicitly prohibits its employees from using nonpublic information to trade in another company's stock, an employee who violates that prohibition will violate Section 10(b). If, on the other hand, a company explicitly permits its employees to trade in another company's stock, an employee who trades will not violate the confidence of her employer and will not run afoul of Section 10(b)"). The question of whether a breach of private contract itself can trigger public enforcement is not unique to securities law. *See,* Daniel A. Crane, *Intellectual Liability*, 88 TEX. L. REV. 253, 265-69 (2009). Contrary to the *Panuwat* case, the Ninth Circuit ruled that the breach of private contract itself does *not* trigger a violation of federal antitrust law. FTC v. Qualcomm, Inc., 969 F.3d 974, 995 (9th Cir. 2020) ("[T]he FTC still does not satisfactorily explain how Qualcomm's alleged breach of this contractual commitment *itself* impairs the opportunities of rivals.").

[196] *See supra* Part II.A.1.

[197] *See* Khanna, *supra* note 70, at 17 ("Compliance systems may also have spillover effects that impact other firms . . . . Although challenging to measure, these too should be counted in the social analysis."); Stark et al., *supra* note 50.

[198] For a substantive, doctrine-based criticism of the *Panuwat* case, see Stephen M. Bainbridge, *SEC Takes a Crack at Expanding Misappropriation Theory to "Shadow" Insider Trading*, WASH. LEGAL FOUND. LEGAL PULSE (Sept. 7, 2021), https://www.wlf.org/2021/09/07/wlf-legal-pulse/sec-takes-a-crack-at-expanding-misappropriation-theory-to-shadow-insider-trading/ [https://perma.cc/R9BX-JY6Z] ("Shadow trading thus

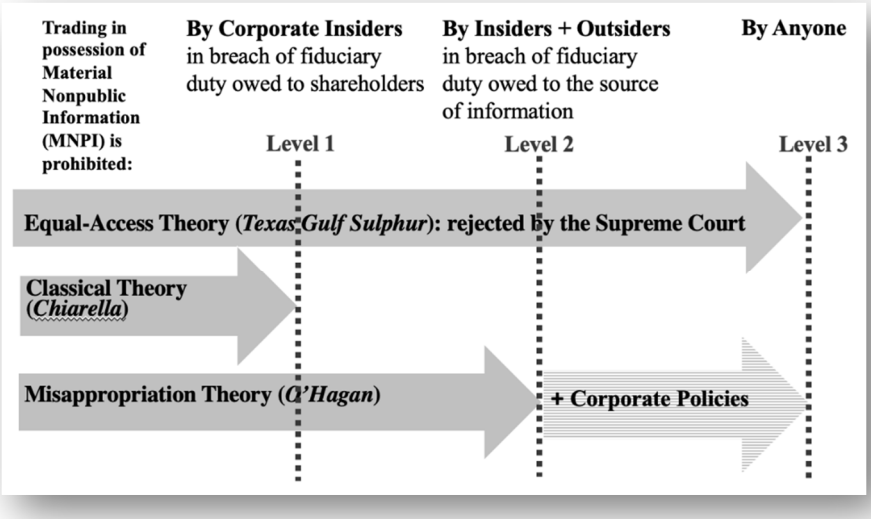
illustrates, current federal law prohibits insider trading up to Level 2 (prohibiting corporate insiders and outsiders who owe a fiduciary duty to the source of information from trading while in possession of MNPI), but corporate policies can stretch federal law to Level 3 (prohibiting anyone from trading in possession of MNPI). The district court in *Panuwat* sees that such an extension through a corporate policy is valid under the misappropriation theory. Thus, the expansive corporate policy is not more stringent than federal law because its implementation simultaneously shifts the boundary of federal law to Level 3. This interpretation raises concerns, primarily due to its potential to revive the equal access theory (Level 3), which once stood as the most expansive prohibition on insider trading in history[199] but had been explicitly rejected by the Supreme Court.[200]

moves the SEC a long way in the direction of restoring the equal access to information theory the Supreme Court long ago rejected."); *see also* Ryan Fane, Case Note, *Agency Problems and the Misappropriation Theory of Insider Trading in* SEC v. Panuwat, U. CHI. L. REV. ONLINE (May 13, 2022), https://lawreviewblog.uchicago.edu/2022/05/13/fane-insider-trading/ [https://perma.cc/94WJ-EVX9] (stating that the underlying interest of insider trading prohibition would be "better served by securities law helping companies to manage this behavior [of insider trading] themselves by encouraging disclosure of these trades to corporate boards").

[199] *See* SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 848 (2d Cir. 1968).

[200] Chiarella v. United States, 445 U.S. 222, 232-33 (1980).

Figure 3. How Corporate Policies Affect Federal Insider Trading Law



This Article does not aim to propose the optimal level of insider trading prohibition, but from a contractual discretion perspective, it seems quite sensible to argue that individual companies should not be given the discretion to customize their policies to circumvent Supreme Court decisions.[201]

B. Lax Internal Control: Related Party Transaction Policies

It is uncommon for a corporate policy to directly contradict the laws in place. Companies, however, tend to have room for customized compliance even when they deal with multiple rules from multiple authorities as discussed in this Part.

1. External Regulations on Related Party Transactions

The term "related party transactions" refers to transactions between a company and its directors, executives, or shareholders with more than five percent ownership of the company.[202] Because individuals in these

[201] *See* Fisch, *Stealth Governance*, *supra* note 28, at 923-26.

[202] 17 C.F.R. § 229.404(a) (2023).

roles have decision-making power on both sides of a related party transaction, there is a potential risk that they will use that decision-making power for their personal benefit at the expense of the company's interests.[203] Despite the potential risk of conflicts of interest, related party transactions can also benefit companies.[204] Recognizing that a blanket ban on related party transactions, including potentially beneficial ones, could harm companies' interests, the current legal framework opts for a screening process instead of an outright prohibition.[205]

Related party transactions — self-dealing transactions between a company and those who have significant control over the company's decision-making process — are subject to layers of external regulations, both at the federal and state levels.[206] Furthermore, related party transactions are regulated by various corporate policies, such as codes of conduct, corporate governance policies, policies specifically concerning directors' related party transactions, and board committee charters. Thus, a company must integrate all of the relevant external and internal rules regarding related party transactions into a well-orchestrated internal process in the form of corporate policies and procedures.

The SEC, the stock exchanges, and the state courts each use a distinct approach to monitoring related party transactions, but all pursue a common goal: differentiating beneficial related party transactions from non-beneficial ones, rather than banning related party transactions entirely. Accordingly, to identify beneficial related party transactions, the current regulatory regime monitors three different stages: 1) disclosure, 2) review by an independent entity, and 3) approval by an independent entity.[207]

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[203] *See supra* note 71 and accompanying text.

[204] *See* Min, *Cooperative Policing*, *supra* note 54, at 666-67.

[205] For a theoretical analysis of rulemaking options for self-dealing transactions, see Zohar Goshen, *The Efficiency of Controlling Corporate Self-Dealing: Theory Meets Reality*, 91 CALIF. L. REV. 393, 401-408 (2003) (introducing four possible solutions to self-dealing: prohibition, majority-of-the-minority vote, the fairness test, and nonintervention).

[206] *See infra* Part II.B.1.a–c.

[207] *See infra* Figure 4.

a. Federal Securities Regulation

The SEC's primary monitoring mechanism is a mandatory disclosure requirement.[208] Regulation S-K Item 404 (a) mandates that every public company disclose any transaction between the company and a "related person" if that transaction exceeds $120,000 and the related person has a material interest.[209] This SEC rule does not evaluate which related party transactions are permissible; instead, it requires companies to publicly disclose any potentially conflicting transactions and let investors decide how to evaluate the information in the disclosure.[210]

Compared to Item 404 (a), the accompanying provision, Item 404 (b), has been largely overlooked by scholars. Regulation S-K Item 404 (b) (1) requires a company to explain its policies and procedures for reviewing and approving related party transactions subject to the disclosure requirement.[211] Again, the SEC does not dictate specific ways to review and approve these transactions.[212] The SEC rule grants a company discretion to create a customized process for review and approval that best suits the company as long as its policies and procedures are publicly available. Although the SEC does not evaluate the content and quality of each company's review and approval policies,[213] Item 404 (b) (2)

[208] *See e.g.*, Ann M. Lipton, *Beyond Internal and External: A Taxonomy of Mechanisms for Regulating Corporate Conduct*, 2020 WIS. L. REV. 657, 679 (2020) (explaining how the mandatory disclosure requirement ensures that corporate managers will attend to certain matters and provides another mechanism for the government to exercise regulatory control); Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 872 (2003) (discussing the expansion of the mandatory disclosure regulation since 1934).

[209] 17 C.F.R. § 229.404(a) (2023). The term "related person" includes a director, executive officer, and five percent shareholder. For the complete coverage of the term "related person," see *id.* ("Instructions to Item 404(a)").

[210] *See* Executive Compensation and Related Person Disclosure, 71 Fed. Reg. 53158 (Sept. 8, 2006) (codified at 17 C.F.R. pts. 228-29, 232, 239-40, 245, 249 and 274).

[211] 17 C.F.R. § 229.404(b)(1) (2023).

[212] *Id.* The SEC only suggests *exemplary* features of the policies. *See id.*

[213] For deterrence effect of securities disclosures, see Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Shareholder Disclosure*, 37 YALE J. ON REGUL. 499, 510 (2020) ("The possibility that illegal or unethical behavior will be revealed . . . helps deter [companies] from engaging in such behavior in the first place."); Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1289 (1999).

clarifies that a company's discretion in the review and approval process does not waive the requirement to disclose related party transactions. It explicitly requires a company to "[i]dentify any transaction required to be reported under [Item 404 (a)] . . . where such policies and procedures did not require review, approval or ratification."[214] Item 404 (b)(2) says that all related party transactions must be disclosed regardless of whether they are subject to review and approval in the company's policies and procedures.[215]

Which transactions should be disclosed depends on the application of the "materiality" standard. If the company determines that a related party does not have a material interest in a transaction between itself and another company that exceeds $120,000, the transaction will be excluded from related party transactions and not be disclosed.[216] Although the SEC has the power to enforce against a company's failure to disclose related party transactions, it is nearly impossible for the SEC to prove what was not disclosed because only the company has information about undisclosed transactions at the time of disclosure.

b. Stock Exchange Listing Rules

The second source of external regulation on related party transactions comes from the major U.S. stock exchanges, such as the NYSE and the Nasdaq. When companies go public to raise capital from public investors, they can choose which stock exchange to use as their trading platform.[217] To be listed and traded, companies must meet certain criteria set by each stock exchange.[218] A listing requirement of

[214] 17 C.F.R. § 229.404(b)(2) (2023).

[215] *See id.*

[216] *See, e.g.*, Bratton, *supra* note 61, at 1202-04 (discussing the nature of self-interested transactions reported by listed companies); George S. Georgiev, *Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation*, 64 UCLA L. REV. 602, 606-12 (2017) (discussing the contours of the materiality standard); Min, *Cooperative Policing*, *supra* note 54, at 683-84 (describing SEC regulation 404(b)); Yaron Nili, *Out of Sight, Out of Mind: The Case for Improving Director Independence Disclosure*, 43 J. CORP. L. 35, 73 (2017) (arguing that the SEC requirements can go a step further by also requiring a description of the transaction that exceeds $120,000).

[217] *See* Geeyoung Min & Kwon-Yong Jin, *Relational Enforcement of Stock Exchange Rules*, 47 BYU L. REV. 149, 165-67 (2021).

[218] *See* Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453, 1477-78 (1997).

both the NYSE and the Nasdaq is that a company's "independent body of the board of directors" should review and oversee related party transactions subject to disclosure under the SEC's rules.[219]

Stock exchanges, as quasi-regulators,[220] build upon the SEC's disclosure requirements. Going a step further than asking for the disclosure of related party transactions, both the NYSE and the Nasdaq require independent directors to *review* the transactions.[221] As the SEC supervises the stock exchange rulemakings, the NYSE's, and Nasdaq's rules on related party transactions mesh well with the SEC rule but focus on a different part of the monitoring process. The SEC focuses on disclosure, and the stock exchanges heighten the scrutiny of the review

[219] NASDAQ LISTING RULES, *supra* note 56, § 5630(a) ("Each Company that is not a limited partnership shall conduct an appropriate review and oversight of all related party transactions for potential conflict of interest situations on an ongoing basis by the Company's audit committee or another independent body of the board of directors. For purposes of this rule, the term 'related party transaction' shall refer to transactions required to be disclosed pursuant to Item 404 of Regulation S-K under the Act."); NYSE LISTED COMPANY MANUAL, *supra* note 56, § 314.00 ("A company's audit committee or another independent body of the board of directors, shall conduct a reasonable prior review and oversight of all related party transactions for potential conflicts of interest and will prohibit such a transaction if it determines it to be inconsistent with the interests of the company and its shareholders. For purposes of this rule, the term 'related party transaction' refers to transactions required to be disclosed pursuant to Item 404 of Regulation S-K under the Securities Exchange Act.").

[220] *See* Marcel Kahan, *Some Problems with Stock Exchange-Based Securities Regulation*, 83 VA. L. REV. 1509, 1510 (1997); Mahoney, *supra* note 218, at 1457; Min & Jin, *supra* note 217, at 171-176; Adam C. Pritchard, *Self-Regulation and Securities Markets*, 26 REGUL. 32, 33-34 (2003); A.C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 977 (1999).

[221] The term "independent body of the board of directors" is interpreted as being equivalent to a body of independent directors, which includes any board committees comprised solely of independent directors, such as the audit committee and corporate governance committee. *See* Brian V. Breheny, Raquel Fox, Marc S. Gerber, Andrew J. Brady, Ryan J. Adams, Caroline S. Kim, James Rapp, Leo W. Chomiak, Jeongu Gim & Khadija L. Messina, *NYSE Restores Thresholds for Related Party Transactions to Align with SEC Disclosure Requirements*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Aug. 26, 2021), https://www.skadden.com/insights/publications/2021/08/nyse-restores-thresholds [https://perma.cc/4PQR-7Z9J] ("The [NYSE] Rule Proposal reinstates those thresholds so that the scope of related party transactions subject to *independent directors' review under Section 314.00* is again aligned with the SEC disclosure rules." (emphasis added)).

process by mandating reviews by independent entities populated solely by independent directors.[222]

c. State Corporate Law

The third source of external regulation on related party transactions is state corporate law, both statutory and case law. Directors, officers, and controlling shareholders owe a fiduciary duty of loyalty to the company,[223] and related party transactions' potential conflict of interest triggers the most rigorous judicial review for corporate actions.[224] Rather than applying the most stringent judicial review, the entire fairness review, to every related party transaction, state law offers statutory safe harbor provisions for cleansing the taint in directors' self-dealing transactions.[225] If a potential conflict of interest transaction was disclosed and approved by disinterested directors or shareholders, the transaction will be subject to business judgment review instead.[226] Under state corporate law, both *ex ante* screening mechanisms (e.g., disclosure and approval) and *ex post* remedy (e.g., litigation) are used for effective monitoring of related party transactions.[227] The evolution of the fiduciary duty of loyalty and statutory safe harbor provision has been made independently from federal law until recently, making this evolution something corporations must monitor moving forward.[228]

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[222] *See supra* note 56 and accompanying text.

[223] *See* Bratton, *supra* note 61, at 1177.

[224] *See id.* at 1182.

[225] *See* DEL. CODE ANN. tit. 8, § 144 (2023); MODEL BUS. CORP. ACT ch. 8,§§ 8.01-8.11 (AM. BAR ASS'N 2017).

[226] The Delaware court recently clarified how to interpret the three prongs of the safe harbor provision, Toedtman v. TurnPoint Med. Devices, Inc., No. N17C-08-210, 2019 WL 328559, at *9 (Del. Super. Ct. Jan. 23, 2019) ("Upon Approval by disinterested directors under § 144(a)(1), or approval by disinterested shareholders under § 144(a)(2), the Court will review the interested transaction under the business judgment rule. . . . When 'neither shareholder ratification or disinterested director approval' can be obtained, the 'intrinsic fairness' standard governs an analysis under § 144(a)(3).")

[227] Min, *Cooperative Policing*, *supra* note 54, at 676-80.

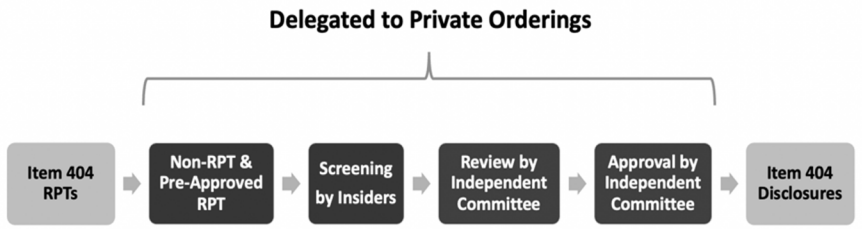
[228] *See, e.g.*, Jill E. Fisch, *The New Federal Regulation of Corporate Governance*, 28 HARV. J.L. & PUB. POL'Y 39 (2004) (discussing recent federal regulatory reforms that affect state law on corporate governance); Renee M. Jones, *Does Federalism Matter? Its Perplexing*

d. Coordination of Overlapping Rules

Each company needs to integrate all relevant rules into one streamlined related party transaction policy. The SEC requires companies to disclose their policies and procedures regarding related party transactions in their SEC filings,[229] but it does not necessarily ask for a stand-alone written policy. Most companies tend to disclose only a summary of their policies and procedures in their proxy statements, rather than disclosing all the details of a stand-alone policy.[230] In that sense, the sample companies made extra efforts to be transparent by voluntarily publishing stand-alone policies and by detailing their internal review and approval processes. This Article aims to better understand how companies deal with related party transactions based on new information available in those stand-alone policies and procedures.[231]

The analysis of the related party transaction policies from 101 companies shows that most related party transaction policies and procedures follow a common decision-making flow, as shown in Figure 4 below.

Figure 4. Private Ordering in Related Party Transaction Policies



Role in the Corporate Governance Debate, 41 WAKE FOREST L. REV. 100 (2006) (describing the tension between federalism and corporate governance).

[229] 17 C.F.R. § 229.404(b)(1) (2023).

[230] By contrast, Amazon (Nasdaq: AMZN) does not have a written policy on related party transactions. *See* Amazon.com, Inc., Proxy Statement (Form DEF 14A) 74 (May 26, 2021) ("We do not have written policies or procedures for related person transactions but rely on the Audit Committee's exercise of business judgment, consistent with Delaware law, in reviewing such transactions.").

[231] *See infra* Appendix.

A baseline for all the sample related party transaction policies is the definition of related party transactions found under the SEC Regulation S-K Item 404 (a)'s disclosure requirement.[232] An independent board committee is the designated authority (with "formal" authority) to review and approve the transactions to comply with stock exchange rules.[233] Approved related party transactions will be disclosed to shareholders in a proxy statement, which becomes available to the public. The SEC relies on a "disclosure-based regulatory scheme,"[234] and SEC Regulation S-K Item 404 (b) (1) mandates disclosure of policies and procedures relating to the review process of related party transactions. However, the regulation does not mandate any specific process, nor does the Commission evaluate individual companies' policies and procedures.[235] In short, companies have ample discretion in designing their own review processes.

An examination of the sample policies reveals two prevalent procedures: (1) Categorical Exclusions and (2) Screening by Insiders. Both procedures are used to reduce the amount of disclosure and are subject to an independent board committee's review.[236] The procedures create a trade-off between efficiency and potential agency costs.[237]

2. Boundary Customization: Reduction by Categorical Exclusion

As shown in Table 4 below, about eighty-one percent (eighty-two out of 101) of sample policies adopt pre-selected categorical exclusions.[238] Two types of categorical exclusions exist: (1) **Non-Related Party Transactions ("Non-RPTs")** (forty-seven percent of all policies): transactions excluded from related party transactions from the

[232] 17 C.F.R. § 229.404(a) (2023).

[233] *See* NASDAQ LISTING RULES, *supra* note 56, § 5630(a); NYSE LISTED COMPANY MANUAL, *supra* note 56, § 314.00.

[234] *See* SEC Final Rule, Disclosure by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002 (Mar. 3, 2003), https://www.sec.gov/rules/2003/03/disclosure-required-sections-406-and-407-sarbanes-oxley-act-2002 [https://perma.cc/76GY-8AFB] ("Such an approach is consistent with our disclosure-based regulatory scheme.").

[235] 17 C.F.R. § 229.404(b)(2) (2023).

[236] *See infra* Appendix.

[237] *See infra* Part II.C.

[238] For detailed information, see *infra* Appendix.

beginning;[239] and (2) **Pre-Approved Related Party Transactions ("Pre-Approved RPTs")** (thirty-four percent of all policies): related party transactions deemed to be pre-approved by the company.[240] Among the sample policies, Non-RPTs are used more frequently than Pre-Approved RPTs. Based on the sample, employees do not need to disclose Non-RPTs to their companies, but they do need to disclose Pre-Approved RPTs to internal reviewers (e.g., general counsel). However, in about two-thirds (twenty-three out of thirty-five) of Pre-Approved RPT cases, the internal reviewers' disclosure obligation was waived.[241] Only twelve sample policies require the internal reviewers to report a list of the Pre-Approved RPTs to an independent board committee on an annual basis.[242] For these companies, at least the committee will have access to information about Pre-Approved RPTs, even though the extensiveness of the committee's review is unclear.

[239] *See, e.g.*, AM. INT'L GRP., INC., RELATED-PARTY TRANSACTIONS APPROVAL POLICY § 2.1. (2014), https://www.aig.com.ph/content/dam/aig/apac/philippines/documents/reports/aig-related-party-transactions-approval-policy.pdf [https://perma.cc/48DD-P8A8] ("[T]he following shall not be Related-Party Transactions").

[240] *See, e.g.*, UBER, CORPORATE POLICY ON RELATED PARTY TRANSACTIONS § D.2 (2022), https://s23.q4cdn.com/407969754/files/doc_governance/2022/FINAL-Related-Party-Transactions-Policy-2.07.22-on-IR-Website.pdf [https://perma.cc/4QGD-GSRF] (containing a section titled Pre-Approved Transactions, which states in part: "The following categories of Related Party Transactions do not need to be presented to the Audit Committee for review and approval").

[241] *See, e.g.*, THE PROCTOR & GAMBLE CO., RELATED PERSON TRANSACTION POLICY § III(a) (2023), https://assets.ctfassets.net/oggad6svuzkv/5aKHtEdBoOgfJTJ8G4ftRP/e350ec3d1d532a41ae80d74223f179dc/POLICY_-_Related_Person_Transaction_Policy_April_2023.pdf [https://perma.cc/H8NN-2Q46] ("[T]he following categories of Related Person Transactions and/or Related Person interests do not need to be presented to the Committee for review and approval because the Committee has determined that they do not present a 'direct or indirect material interest' on behalf of the Related Person.").

[242] *See, e.g.*, CENTURY ALUMINUM, STATEMENT OF POLICY REGARDING RELATED PARTY TRANSACTIONS 3 (2021), https://s23.q4cdn.com/963478445/files/doc_downloads/governance/2021/SEP21/Related-Party-Transaction-Policy-Q3-2021-Final-and-Board-Approved.pdf [https://perma.cc/E37L-4R35] ("The Audit Committee shall receive periodic reports from management describing the Pre-Approved Transactions under this Section C.6.").

Table 4. The Frequency of Categorical Exclusions

	No Disclosure Requirement	**Disclosure Requirement**	**Total**
Categorical Exclusions: Non-RPTs	48	0	48 (47.0%)
Categorical Exclusions: Pre-Approved RPTs	23	12	35 (34.3%)
No Categorical Exclusions	N/A	N/A	19 (18.6%)
Total			102 (100%)[243]

The number of exclusion categories in one company ranges from zero to eleven,[244] and the average number of categorical exclusions per company is 5.1. As Table 5 below indicates, companies often use the SEC's categorical exceptions for waiving disclosure requirements as prototypes.[245] Even in this case, companies almost always adopt some variation from the SEC's categories, and companies also create non-SEC rule-based categorical exclusions.

[243] One company uses both types of categorical waivers and is counted twice, bringing the total from 101 to 102. *See* Ameren Corporation Related Person Transactions Policy 1-2, 4. (2018).

[244] *See infra* Appendix. Related Party Transaction Policies of Howmet Aerospace Inc. (NYSE: HWM) and Activision Blizzard, Inc. (Nasdaq: ATVI) have eight and ten categorical exclusions, respectively. HOWMET AEROSPACE, RELATED PERSON TRANSACTION APPROVAL POLICY 1-3 (2013), https://www.howmet.com/global/en/investors/pdf/Related-Person-Transaction-Approval-Policy.pdf [https://perma.cc/3SU3-D3U5]; ACTIVISION BLIZZARD, INC., RELATED PERSON TRANSACTIONS POLICY 2 (2016), https://investor.activision.com/static-files/799bf1e4-4bd5-4417-86de-c686802b7610 [https://perma.cc/3QXN-ZJT2].

[245] 17 C.F.R. § 229.404(a) (2023).

Table 5. The Most Frequent Bases of Categorical Exclusions

Rank	SEC Rule-Based Exceptions	Non-SEC Rule-Based Exceptions
1	Executive compensation	Position at non-profit organization
2	Director compensation	Indemnification and advancement
3	Pro-rata basis ownership benefits	Same benefit as similarly situated employee
4	Less than _% of ownership in other company	Non-executive employee in other company
5	Director in another company	Trivial transactions less than $__.

3. Procedural Customization: Approval by Insiders

Another common practice observed from the sample policies is the screening by corporate insiders prior to an independent board committee's review. In more than seventy percent of the sample related party transaction policies,[246] corporate insiders are given the formal authority to screen related party transactions and decide if an individual's interest in the transaction amounts to be "material" enough for an independent board committee's review and approval.[247] The typical provision on the screening by insiders reads:

> Company management will be responsible for determining whether there is a Transaction with a Related Person requiring review under this Policy, including whether the Related Person's interest in a transaction is material, *based on their review of all facts and circumstances*. Upon determination by management that there exists a Transaction with a Related

[246] *See infra* Table 7.

[247] Basic Inc. v. Levinson, 485 U.S. 224, 236 (1988); *see supra* Part II.B.1. For the definition of the materiality, see 17 C.F.R. § 270.8b-2 (2023) ("The term 'material,' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before buying or selling any security of the particular company.").

> Person subject to this Policy, the material facts shall be disclosed to the Corporate Governance Committee.[248] (emphasis added)

Given that corporate insiders are likely to have more relevant information, they might be better positioned to evaluate potential related party transactions based on "all facts and circumstances."[249] An independent committee is solely comprised of independent directors, who are not full-time employees of the company, and the committee usually meets only several times a year.[250] Thus, corporate insiders' screening process can significantly reduce the number of transactions for an independent committee to review, and the committee can use its limited time more efficiently. However, those benefits can possibly be outweighed by the agency costs, including possible abuse of such discretion by the insiders. In order to achieve a proper balance, a more effective monitoring mechanism for the corporate insiders' screening decisions is needed.[251] Corporate insiders who screen related party transactions are under various titles, as shown in Table 6 below.

Table 6. The Most Frequent Type of Screening Insiders[252]

Rank	Title of Screening Insiders	Frequency
1	General Counsel	25
2	Corporate Secretary	15
3	Legal Department	6
4	Management	6
5	Chief Legal Officer	2

[248] AM. ELEC. POWER CO., INC., RELATED PERSON TRANSACTION APPROVAL POLICY 1 (2012), https://www.aep.com/assets/docs/investors/governance/RELATED-PERSON-TRANSACTION-APPROVAL-POLICY.pdf [https://perma.cc/ZQ4W-SX63].

[249] *Id.*

[250] For example, AEP's independent committee in charge of reviewing and approving related party transactions is the Directors and Corporate Governance Committee. The committee is comprised of four independent directors, and the committee met six times in 2022. *See* Am. Elec. Power Co. Inc., Proxy Statement (Form DEF 14A) 18-19 (Mar. 15, 2023).

[251] *See supra* Part I.B.

[252] Others include Chief Executive Officer ("CEO"), Chief Compliance Officer ("CCO"), and Chief Financial Officer ("CFO").

Taken together, as Table 7 below shows, most sample companies use either or both categorical exclusions and insider screening for the transactions. Only eight companies, about eight percent of the entire sample, use neither categorical exclusions nor screening by insiders, and all related party transactions under the SEC's definition are directly subject to an independent committee's review.[253]

Table 7. The Frequency of Customization Per Type

	Categorical Exclusions	**No Categorical Exclusions**	**Total**
Screening by Insiders	57 **(56%)**	14 (14%)	71(70%)
No Screening by Insiders	22 (22%)	8 (8%)	30(30%)
Total	79 (78%)	22 (22%)	101 (100%)

4. Implications for External Regulations

This Subsection discusses how customized corporate policies fit into the existing regulatory regime on related party transactions.

a. Compliance with Federal Securities Regulation

The potential compliance issue with the disclosure requirement under the SEC Regulation S-K Item 404 is that most sample companies' policies carve out the SEC's definition of related party transactions through extensive categorical exclusions[254] or by allowing screening by insiders.[255] Although the SEC mandates companies to disclose all the transactions, including those exempted from review in accordance with companies' policies[256] companies tend to disclose only the transactions

[253] *See infra* Appendix.

[254] *See supra* Part II.B.2 (providing a statistical survey of companies that circumvent the SEC's definition of related party transactions through categorical exclusions).

[255] *See supra* Part II.B.3 (finding that around 70% of surveyed companies had carve-outs to allow screening of related party transactions by insiders).

[256] 17 C.F.R. § 229.404(b)(2) (2023).

that are *approved* by an independent board committee without disclosing exempted transactions.[257]

It is possible, at least in theory, that companies have not disclosed exempted transactions because they did not have any. From the outsider's perspective, it is practically impossible to accurately quantify the level of non-disclosures because only insiders at various levels (e.g., the board, committee, screening insiders, or individuals engaging with related party transactions) have the relevant information.[258] Thus, outsiders cannot truly know whether or not the void of related party transactions can be attributed to a failure of disclosure or the company not having any exempted transactions.

b. Compliance with Stock Exchange Rules

The major stock exchange rules added an independence review requirement on all related party transactions that are subject to disclosure under the SEC rules.[259] Approximately forty-seven percent of the sample companies use various categories of Non-RPTs.[260] When a transaction falls within the defined category, the transaction is carved out from the company's definition of related party transactions. Those transactions are deemed not "material" categorically and are not subject to Rule 404 and relevant stock exchange rules.[261] Extensive use of those exemptions does not facially violate the stock exchange rules, but it may

[257] For the empirical analysis of related party transaction disclosure practices, *see* Bratton, *supra* note 61, at 53; Min, *Cooperative Policing*, *supra* note 54, at 697-713 (providing a detailed illustration of companies' actual disclosure practice of related party transactions).

[258] Compare this problem with the violations of the SEC disclosure requirements revealed through public or private enforcements. *See, e.g.*, Press Release, SEC, SEC Charges the Walt Disney Company for Failing to Disclose Relationships Between Disney and Its Directors (Dec. 20, 2004), https://www.sec.gov/news/press/2004-176.htm [https://perma.cc/NE6Q-RZ44] (reporting that the SEC's enforcement proceedings against Walt Disney Company for failing to disclose certain related party transactions was settled.).

[259] *See supra* Part II.B.1.

[260] *See supra* Part II.B.2.

[261] This is because stock exchange rules on related party transactions apply only to the "transactions required to be disclosed pursuant to Item 404." NASDAQ LISTING RULES, *supra* note 56, § 5630(a); NYSE LISTED COMPANY MANUAL, *supra* note 56, § 314.00.

keep more related party transactions in the dark, which, in turn, can undermine the stock exchanges' independent review requirement.[262]

c. Compliance with State Corporate Law

The sample companies' extensive use of categorical exclusions and insider screening are not easy to reconcile with the fiduciary duty of loyalty obligations under state corporate law.[263] A conflict of interest can lead to a breach of the fiduciary duty of loyalty, and state corporate law applies the "fairness" standard rather than the "materiality" standard in determining whether a breach has occurred. Furthermore, in most states, corporations cannot waive the fiduciary duty of loyalty through private ordering,[264] such as corporate charters.[265] Many categorical exclusions and screenings in the sample policies are based on materiality standards rooted in the SEC regulations, and whether such exclusions and screenings can function as a waiver of the fiduciary duty of loyalty is rather questionable. For example, if a company's related party transaction policy includes categorical exclusions that allow for the waiver of disclosure requirements beyond what is legally allowed under state corporate law, a director involved in one of these excluded transactions may still be held accountable for violating the fiduciary duty of loyalty.[266]

[262] *See supra* Part II.B.1.b.

[263] *See, e.g.*, DEL. CODE ANN. tit. 8, § 144 (2023) (describing the conditions under which a self-interested transaction is not void *per se*).

[264] *Cf.* NEV. REV. STAT. ANN. § 78.138(7) (2023). As a default, Nevada's statute waives corporate managers' fiduciary duty unless they engage in "intentional misconduct, fraud or a knowing violation of the law." Thus, unlike in Delaware, directors' and executives' liability from the breach of fiduciary duty is waived. *See* Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935, 952-53 (2012); Ofer Eldar, *Can Lax Corporate Law Increase Shareholder Value? Evidence from Nevada*, 61 J.L. & ECON. 555, 555-556 (2018).

[265] An important exception to the rule is a corporate opportunity waiver. *See* Gabriel Rauterberg & Eric Talley, *Contracting out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers*, 117 COLUM. L. REV. 1075, 1077-78 (2017).

[266] *See supra* Part II.B.1.c.

C. Strategic Compliance

1. Considerations Behind Making Corporate Policies

Why do companies, even the same companies that disclose both policies, show a strong tendency to make their insider trading policies more stringent than what the law requires while relaxing the scrutiny in their related party transaction policies? This Subsection will discuss three alternative theories that account for this phenomenon and argue that the first two, agency cost theory and efficiency theory, do not fully explain the puzzle. This Article then introduces the third theory, strategic compliance, which argues that external enforcement intensity is the primary driver of the divergence. Although the strategic compliance theory is not mutually exclusive from the other two theories, this Article argues that it better explains the divergence.

a. Agency Cost Theory

The first theory, based on agency concepts, focuses on corporate managers' self-interest in creating policies. Agency problems, stemming from the separation of ownership and control,[267] is the most foundational concern in corporate law and governance. Shareholders, as economic owners of a company, delegate control over the day-to-day operation of the company to the corporate managers.[268] Agency problems occur when directors put their own interests before shareholders' (i.e., conflict of interest)[269] or when directors perform incompetently (i.e., shirking).[270] In the corporate policy context, one might argue the divergence stems from the difference in the group of employees that each corporate policy targets. While related party transaction policies only apply to high-level corporate managers and

[267] *See* ADOLF A. BERLE, JR. & GARDINER C. MEANS, MODERN CORPORATION AND PRIVATE PROPERTY 334-35 (1932); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308-10 (1976).

[268] *See* Zohar Goshen & Richard Squire, Essay, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 809 (2017).

[269] *See* Jensen & Meckling, *supra* note 267, at 313.

[270] *Id.* at 309.

significant owners, insider trading policies apply to all employees.[271] Thus, under the agency cost theory, directors are incentivized to relax corporate policies that are more closely related to their personal interests.

The agency cost theory, in its most simplistic form, plausibly explains the lenient corporate policies, but it does not fully explain why corporate managers make insider trading policies even more stringent than what is required under the federal securities laws, instead of leaving them at the same level as the external laws.[272] At least in theory, corporate managers can obtain significant benefits from engaging in informed trading legally, and this should incentivize the managers to adopt a more relaxed insider trading policy for their personal benefit.[273] Furthermore, as the same group of corporate managers is involved in reviewing and applying all corporate policies in each company, how they use their discretion to tailor the level of stringency in the same company will likely be consistent across various policies. This still leaves the divergence puzzle – why corporate managers apply different approaches by topics – unresolved. Thus, the agency cost theory does not satisfactorily account for the policy-to-policy difference within a firm.

b. Efficiency Theory

The efficiency theory will interpret the current variation in stringency as a result of the corporate managers' quest to make the process more efficient for the firm and its shareholders.[274] Not all related party transactions are illegal or harmful, and directors' main duty is to screen harmful ones from beneficial ones.[275] According to this theory, categorical waivers and final approvals by insiders (e.g., general counsel)

[271] *See supra* Parts II.A.1, II.B.1.

[272] *See supra* Figure 3.

[273] *See e.g.*, Yoon-Ho Alex Lee, Lawrence Liu & Alessandro Romano, *Shadow Trading and Corporate Investments*, 7 J.L. FIN. & ACCT. 191, 203-06 (2023) (discussing the benefits to corporate managers of engaging in shadow trades); Yoon-Ho Alex Lee & Alessandro Romano, *Shadow Trading and Macroeconomic Risk*, 91 HARV. BUS. L. REV. (forthcoming 2023) (". . . [A] corporation might even wish to permit its employees to engage in shadow trades as a form of compensation.").

[274] *See* Schwarcz, *supra* note 27, at 321-22.

[275] *See* Min, *Cooperative Policing*, *supra* note 54, at 686.

are to relieve the independent reviewer's heavy workload, so that the independent reviewer (e.g., an independent board committee) can concentrate on a smaller number of transactions. In large companies, like the companies in the sample, some degree of delegation is inevitable, because sending all related party transactions to independent directors for review is not practically feasible.[276] Insiders, such as general counsel, may be better positioned to evaluate the trade-offs between the harms and benefits associated with the transactions.

Despite such benefits, the efficiency theory tends to focus too heavily on procedural efficiency while disregarding substantive efficiency. This bias may underestimate the consequences of failing to screen harmful related party transactions.[277] In that light, categorical waivers may be procedurally efficient, but they are unlikely to be substantively efficient. Also, this theory, similar to the agency cost theory, falls short of explaining why companies have stricter prohibitions on insider trading than federal law. Furthermore, when we consider the harms inflicted by each underlying action, the policy-to-policy divergence becomes more puzzling. Setting aside the issues of external enforcement, related party transactions can directly harm companies, but insider trading harms the integrity of the securities market.[278] Market integrity should be protected, but each company demonstrating a stronger inclination to protect the market integrity than to monitor direct harm to the company cannot be fully explained. [279] Per the efficiency theory, it would be more intuitive to observe a more stringent related party transaction

[276] *See supra* note 250 and accompanying text.

[277] *See supra* note 71 about WeWork example.

[278] *See* Insider Trading Arrangements and Related Disclosures, 87 Fed. Reg. 80362, 80362-63 (Dec. 29, 2022) (codified at 17 C.F.R. pts. 229, 232, 240, 249) ("The securities laws' antifraud prohibitions that proscribe insider trading, including Section 10(b) of the Exchange Act, play an essential role in maintaining the fairness and integrity of our securities markets. . . . [Insider trading] harms not only individual investors but also undermines the foundations of our markets by eroding investor confidence.").

[279] *See* Khanna, *supra* note 70, at 19 ("Although social net benefits [of compliance activities] are important, ignoring private ones is myopic. Focusing on private costs and benefits may be critical in thinking of how to incentivize firms to engage in compliance when it is socially desirable, but perhaps not privately desirable.").

policy and a more lenient insider trading policy, and this is not consistent with what we observe in the current practice.[280]

c. Strategic Compliance Theory

Strategic compliance theory, on the other hand, stresses the role of external enforcement in shaping internal corporate policies. The theory explains that the divergence of strictness in corporate policies by subject matter occurs primarily because of corporate managers' incentives to avoid or mitigate enforcement actions against their companies. This theory does not replace the earlier two theories, but rather complements them. According to the strategic compliance theory, both well-intentioned and ill-intentioned companies take external enforcement as a key consideration, and strategically implement stringent internal policies when external enforcement is strong and adopt lenient policies where external enforcement is weak, so as to minimize liability risks.[281]

The divergency trend in insider trading policies and related party transaction policies is mainly because insider trading is more detectable, and results in more severe sanctions. As to the *likelihood of detection*, while the technology used by regulators to detect insider trading is rapidly advancing,[282] related party transactions that are problematic are

[280] *See infra* Appendix.

[281] *See* Langevoort, *supra* note 70, at 123 ("The prevailing idea is that firms are expected to invest in precaution (i.e., compliance investments) up to a level where the marginal benefits in terms of diminished liability risk to the firm equal the marginal costs associated with such efforts.").

[282] *See* Todd Ehret, *SEC's Advanced Data Analytics Helps Detect Even the Smallest Illicit Market Activity*, REUTERS (June 30, 2017, 10:11 AM), https://www.reuters.com/article/bc-finreg-data-analytics/secs-advanced-data-analytics-helps-detect-even-the-smallest-illicit-market-activity-idUSKBN19L28C [https://perma.cc/FX2A-9NBY] ("[T]he speed and efficiency that comes with the use of enhanced data analytics is helping the SEC to quickly detect and successfully enforce insider trading cases no matter how small."); Press Release, SEC, SEC Files Multiple Insider Trading Actions Originating from the Market Abuse Unit's Analysis and Detection Center (July 25, 2022), https://www.sec.gov/news/press-release/2022-129 [https://perma.cc/QPR3-8SR8] ("Each of the three actions announced today originated from the SEC Enforcement Division's Market Abuse Unit's (MAU) Analysis and Detection Center, which uses data analysis tools to detect suspicious trading patterns.").

much more difficult to detect from the outside.[283] Also, the *level of penalty* and accompanying reputational damage can be more severe against illegal insider trading[284] than against harmful related party transactions.[285] Insider trading policies at some sample companies explicitly emphasize the effectiveness of detecting insider trading and rigorous enforcement by external authorities.[286] On the other hand,

[283] One might think that related party transactions are more visible because they appear on financial statements pursuant to the Financial Accounting Standards Board ("FASB")'s Accounting Standard Codification ("ASC") 850-10-05-5. The existence of a transaction may be visible but given that identification of related party transactions solely relies on the *self-reporting* of "relatedness," whether related parties have material interests in the transaction is still hardly detectable from the outside. The lack of details in disclosure often makes it difficult to evaluate related party transactions even when they have been disclosed. *See, e.g.*, Jonathan Weil, *FTX Disclosed Related-Party Transactions but Didn't Name Names*, WALL ST. J. (Nov. 18, 2022, 5:30 AM EST), https://www.wsj.com/articles/ftx-disclosed-related-party-transactions-but-didn't-name-names-11668750387 [https://perma.cc/KLV5-WGEQ] ("FTX Trading last year paid $250 million . . . to an unnamed related party for 'software royalties' . . . . 'The auditors would have to know who the related party is.'"); *cf.* Michael W. Toffel & Jodi L. Short, *Coming Clean and Cleaning Up: Does Voluntary Self-Reporting Indicate Effective Self-Policing?*, 54 J.L. & ECON. 609, 611 (2011) (empirically showing that a company's self-reporting reliably indicates effective self-policing efforts.).

[284] *See supra* Parts II.A.2, II.B.2; *see, e.g.*, Michael A. Perino, *Real Insider Trading*, 77 WASH. & LEE L. REV. 1647, 1659 (2020) (discussing sentencing enhancements for insider trading); Verity Winship, *Disgorgement in Insider Trading Cases: FY2005-FY2015*, 71 SMU L. REV. 999 (2018) (reviewing remedies ordered by the SEC over a ten-year period).

[285] *See supra* Parts II.A.1–2.

[286] *See e.g.*, ALLSTATE, INSIDER TRADING POLICY 12 (revised July 8, 2022) (on file with the author) (The SEC "uses advanced technology to detect insider trading and aggressively pursues violations."); COPART, INC., INSIDER TRADING POLICY 1 (n.d.) (on file with the author) (The SEC, the Financial Industry Regulatory Authority (FINRA) and the NASDAQ Stock Market (NASDAQ) "use sophisticated electronic surveillance techniques to investigate and detect insider trading, and the SEC and the U.S. Department of Justice pursue insider trading violations vigorously."); ADP, INSIDER TRADING POLICY, https://www.adp.com/about-adp/corporate-social-responsibility/ethics/insider-trading-policy.aspx (last visited Sept. 21, 2023) [https://perma.cc/L6YH-Q3SG] (Both the SEC and the FINRA investigate and "are very effective at detecting insider trading. Both the SEC and the U.S. Department of Justice pursue insider trading violations vigorously."); SOLAREDGE TECHNOLOGIES, INSIDER TRADING POLICY 1 (revised on Nov. 30, 2021) (on file with the author) (The SEC, NASDAQ and state regulators (as well as the Department of Justice) "are very effective at detecting and pursuing insider trading cases.").

none of the sample related party transaction policies mention external *enforcement* aside from applicable *regulations*.[287]

Changes in corporate behavior in response to external enforcement intensity are not new,[288] but how they are systematically amplified in corporate private ordering is. When companies implement corporate policies as private ordering, companies seem to increasingly respond to the level of external enforcement in a similar way, rather than assessing and responding to the unique risks of each company. Although strategically responding to the intensity of external enforcement may not be inherently problematic, it can be undesirable when a corporate policy goes against the regulatory goal of encouraging each company to implement the best-tailored policies responding to its own level of compliance risk.[289]

Strategic compliance may appear to align with shareholder interests, but it can expose companies to compliance failures in the long run by channeling firms' compliance resources uniformly to areas where detection rates are high and penalties are severe, leaving certain other compliance areas unattended.[290] Particularly when companies use categorical inclusion or exclusion in corporate policies, strategic compliance may impair effective cooperation between external and internal monitoring in corporate compliance, as discussed below.[291]

2. Strategic Compliance and Informational Flow

There are potential issues with strategic compliance, and analyzing insider trading and related party transaction policies showcases these

[287] Related Party Transaction Policies from the 101 sample companies listed in Appendix are on file with the author.

[288] *See* Arlen & Kornhauser, *supra* note 68, at 3-4, 8-9.

[289] *See* Rule 10b5-1 and Insider Trading, 87 Fed. Reg. 8686, 8695 (Feb. 15, 2022) (codified at 17 C.F.R. pts. 229, 232, 240, 249) ("We recognize that insider trading policies and procedures may vary from company to company and that decisions as to specific provisions of the policies and procedures are best left to the company. Therefore, the proposed amendments do not specify all details that a registrant should address in its insider trading policies, nor do they prescribe any specific language that such policies must include.").

[290] Related Party Transactions are one example. *See supra* Part II.B–C.

[291] *See supra* Parts II.C.1–2.

concerns. On its face, insider trading regulation seems to present a bright-line rule: insider trading is illegal. That is an accurate statement assuming that we know what exactly insider trading is. Just as with related party transactions, however, insider trading has a principle-based element in the *materiality* standard. Trading based on nonpublic information is illegal only when the information is *material*.[292] Similarly, a transaction between a company and its employee needs to be disclosed only if the interest the employee has in the transaction is *material*.[293] Such materiality of information or interest taints the trading or the transaction. Under federal securities law, information is material when there is "a substantial likelihood that the . . . fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available,"[294] and materiality needs to be evaluated each time.

Thus, the critical question would be who should apply the materiality standard to the transactions or trading. It is generally understood that rules are difficult to make but easier to enforce, while standards are easier to make but costly to enforce.[295] The SEC's regulatory regime uses both principles and bright-line rules, relying more on the rules.[296] Rules can give clear guidance on what conduct is and is not appropriate and may also provide companies with a safe harbor from private litigation.[297]

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[292] 17 C.F.R. § 240.10b-5 (2023).

[293] 17 C.F.R. § 229.404(a) (2023).

[294] TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 439, 449 (1976) ("An omitted fact is material if there is a substantial likelihood that a reasonable *shareholder* would consider it important in deciding how to vote." (emphasis added)); *see also* Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988) (applying *TSC* to reasonable investors' investment decisions); Paul Munter, *Assessing Materiality: Focusing on the Reasonable Investor When Evaluating Errors*, SEC (Mar. 9, 2022), https://www.sec.gov/news/statement/munter-statement-assessing-materiality-030922 [https://perma.cc/RH47-GMJ8] ("The basic premise of this disclosure-based regulatory regime is that if investor have timely, accurate, and complete financial and other information, they can make informed, rational investment decisions.").

[295] *See generally* Kaplow, *supra* note 78, at 562-64 (exploring the relative advantages and disadvantages of promulgating a rule or a standard for a given circumstance).

[296] Roel C. Campos, Comm'r, SEC, Speech by SEC Commissioner: Principles v. Rules (June 14, 2007), https://www.sec.gov/news/speech/2007/spch061407rcc.htm [https://perma.cc/W7RE-XG5Q].

[297] *Id.*

However, with regard to internal corporate policies, the SEC consistently expressed its principle-based approaches.[298] Specifically, categorical exclusion and inclusion used in corporate policies transform the SEC's principle-based approach into bright-line rules at the company level, and such transformation seems to go against the SEC's regulatory intent to encourage companies' self-policing function.[299]

The transformation from principles to rules almost shuts down the channel for employees to share information about their trading or transactions for review. For instance, if an insider trading policy prohibits the trading of any other company's stock using material nonpublic information, an employee who inevitably has access to certain nonpublic information, must evaluate if the information is material, unless she gives up stock investment entirely. On the other hand, this disruption of upward information flow to corporate managers will make the prevention and detection of potential misconduct much more difficult.[300]

III. IMPLICATIONS

Based on the foregoing discussions of specific types of corporate policies, this Part extends and generalizes normative implications both at theoretical and practical levels. According to the strategic compliance theory, which shows the driving power of external enforcement in companies' private ordering, this Part proposes the importance of enhancing information flow as the most critical function to satisfy both regulators and regulated companies.

[298] For instance, in its proposed rules for implementation of insider trading policies, the SEC highlights the importance of (1) implementation ("Well-designed policies and procedures that address the potential misuse of material nonpublic information can play an important role in deterring and preventing trading on the basis of material nonpublic information.") and (2) disclosure ("Specific disclosures concerning registrants' insider trading policies and procedures would benefit investors by enabling them to assess registrants' corporate governance practices and to evaluate the extent to which those policies and procedures protect shareholders from the misuse of material nonpublic information" of corporate policies.) Rule 10b5-1 and Insider Trading, 87 Fed. Reg. 8686, 8695 (Feb. 15, 2022) (codified at 17 C.F.R. pts. 229, 232, 240, 249).

[299] *See supra* note 289 and accompanying text.

[300] *See* Arlen, *supra* note 76, at 5 (noting requirements that would enhance deterrence).

A. Transparent Allocation of Authority and Information Flow

There are layers of delegation in corporate policies.[301] At one level, external regulators, such as the SEC and the stock exchanges, can formally delegate to each company the authority to regulate certain corporate transactions.[302] Using the delegated rulemaking authority, each company will develop a corporate policy to comply with the external rules. At another level, within each company, the higher-level authority can delegate responsibility to lower-level employees.[303] Having access to relevant information plays a key role at each step of delegation.[304] After all, both delegations might occur primarily because corporate insiders (e.g., corporate managers) are better aware of the relevant parameters of the transactions.[305]

The board's delegation of authority to corporate insiders can be efficient, particularly when corporate insiders are endowed with better information and can make better-informed decisions that can potentially benefit the corporation and its shareholders. At the same time, delegating to a self-interested agent can undermine the objective of advancing benefits for the corporation. Thus, efficient authority delegation can be maintained only when each delegated individual can be held accountable for her wrongdoing. In that light, securing information flow within a company is a critical element in identifying an individual's wrongdoing and holding her accountable.

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[301] Professors Philippe Aghion and Jean Tirole's seminar paper provides a theory of the allocation of authority within firms, and this Article extends the theory to the delegation from external authorities to firms. (e.g., the SEC's delegation to companies). *See* Philippe Aghion & Jean Tirole, *Formal and Real Authority in Organizations*, 105 J. POL. ECON. 1, 4 (1997) (describing "the two-way interaction between authority and information").

[302] *See supra* Part II.B.1.

[303] *See* Aghion & Tirole, *supra* note 301, at 1. (developing "a theory of the allocation of formal authority (the right to decide) and real authority (the effective control over decisions) within organizations…").

[304] *Id*. at 2 ("A principal who has formal authority over a decision (or activity) can always reverse her subordinate's decision but will refrain from doing so if the subordinate is much better informed and if their objectives are not too antinomic.").

[305] *See* Jennifer Nou, *Subdelegating Powers*, 117 COLUM. L. REV. 473, 487 (2017) ("Social scientists have long recognized that an important function of delegation is to motivate effort and information acquisition.").

Against this backdrop, the first and foremost role of a corporate policy is *allocating formal authority* within a company. A policy delegates the formal authority to the board or a board committee, and the board or the committee, in turn, delegates some of the authority to administer the policy to the officers or other employees within the organization (i.e., corporate insiders). Delegation of authority can be efficient and, especially for large companies, may be inevitable. As directors' independence and knowledge of internal information are likely to be negatively correlated, and independent directors often face time constraints — as many are active officers of other companies or serving on multiple boards — it is not surprising that corporate insiders may be much better positioned to administer corporate policies.[306]

The second critical role of a corporate policy is *information channel creation*. The optimal level of authority allocation and the delegated entity may vary across companies, but all corporate policies affect the level of information flow surrounding the issue. The transparency of the decision-making process, in turn, is crucial to making the allocation of authority effective. The holder of formal authority (e.g., the board) can effectively supervise its delegated authority (e.g., general counsel) for the benefit of the entity with ultimate authority (e.g., shareholders) only when upward information flow is guaranteed.[307]

[306] A related party transaction policy, for instance, gives formal authority to approve related party transactions to a board committee (which consists solely of independent directors) in compliance with stock exchange rules and state corporate law. The committee has a final say on which transactions are permissible or not. But in most companies, the independent board committee delegates its authority to screen related party transactions to corporate insiders, such as the corporation's general counsel. This corporate insider has the formal authority to administer the screening process, primarily because she has more corporate internal information than independent directors about potential related party transactions. The corporate insider has more information about the company, the transaction, and the interested directors associated with the transaction. All that information will make the corporate insider much better positioned to determine which related party transactions are worth the board's review.

[307] *See* Jennifer O'Hare, *Private Ordering and Improving Information Flow to the Board of Directors: The Duty to Inform Bylaw*, 53 U. RICH. L. REV. 557, 558 (2019); Robin Hui Huang & Randall S. Thomas, *The Law and Practice of Shareholder Inspection Rights: A Comparative Analysis of China and the United States*, 53 VAND. J. TRANSNAT'L L. 907, 943 (2020) ("Possession of adequate information is an important precondition for the principal to meaningfully monitor whether the agent performs appropriately, and to decide whether,

Considering this dynamic, both categorical exclusions and inclusions raise concerns because they shut down the upward informational channel from the employees to the internal reviewers (e.g., general counsel), resulting in forcing the employees to apply the standards on their own. When an insider trading policy prohibits trading of all publicly traded stocks, the company does not provide an internal review and screening process that an employee can consult with. Thus, unless the employee quits stock trading entirely, she needs to determine on her own whether she has material nonpublic information that makes her trading unlawful.[308] Similarly, when a related party transaction policy waives disclosure requirements on certain categories of transactions, the determination of whether a transaction falls under those categories needs to be made by an individual employee. Since categorical waivers mean fewer internal screening mechanisms to sort permissible from impermissible transactions, each employee has to evaluate her material interest instead of letting the internal authority (e.g., general counsel) decide. As such, categorical exclusions and inclusions make individual employees themselves apply the materiality standard, and this will, in turn, deprive companies and the SEC of the opportunity to gather information to better discern and detect harmful transactions and trading.

B. Policy Proposals

Based on the foregoing theoretical framework, this Section offers normative proposals related to an *ex ante* mechanism to ensure the efficacy of corporate policy as a critical part of companies' compliance programs.

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and how, to take appropriate action."); Stevelman & Haan, *supra* note 14, at 253-54;. This upward information flow focuses on the information gathering *within* a company as opposed to the information gathering by external government authorities. *See* Vikramaditya S. Khanna, *What Rises from the Ashes?*, 47 J. CORP. L. 1029, 1033 (2022) ("[T]he criminal justice system's much-vaunted ability to compel evidence is perhaps less valuable than it used to be in light of firms' relatively recent growth in compliance efforts.").

[308] *See* Heminway, *Materiality Guidance*, *supra* note 77, at 1013 (contending that ambiguity in the materiality standard for insider trading discourages "desirable trading activities" out of "an abundance of caution").

1. Companies

This Subsection claims that it is desirable for companies to closely monitor the policy content, even in the absence of any corporate misconduct. The efficacy of corporate policies in deterring corporate wrongdoing is largely conditioned on the rigor of enforcement against their violations. But the implied premise here is that corporate policies are well-designed. A largely overlooked but still critical inquiry is how to maintain the high quality of corporate policy content. Rather than tracing back the adequacy of policies only after the violation of external laws, there should be a heightened *ex ante* internal control mechanism for the policy content itself, similar to how other forms of private ordering (e.g., bylaw provisions) can be subject to challenge and dispute.[309]

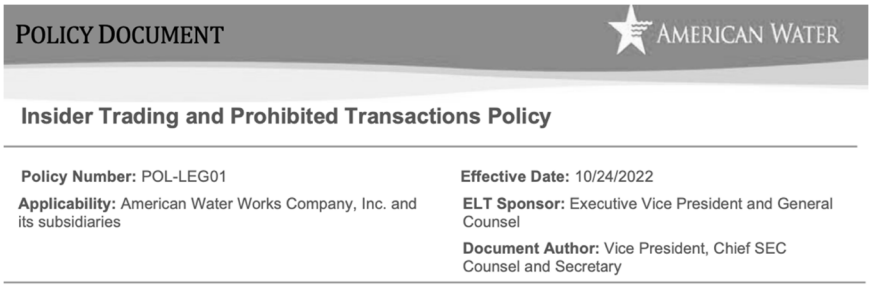
First, transparency of accountability is necessary for the policy content. Typically, corporate insiders (e.g., in-house counsel) draft a corporate policy, and a board committee, comprised of independent directors, approves it. However, stand-alone corporate policies oftentimes do not include the exact amendment dates,[310] and rarely specify the identity of the drafter or approver of each policy.[311] Given the significant influence of corporate policies on employees' day-to-day decision-making and on external enforcement, it is critical to monitor the content of the policy more closely, even before any corporate wrongdoing has occurred. Examples 1& 2 below from American Water and BorgWarner are rare cases where companies voluntarily provide meaningful information about their insider trading policies. Disclosure of the names of drafters or reviewers of each policy will enhance transparency and accountability.

[309] *See, e.g.*, Salzberg v. Sciabacucchi, 227 A.3d 102, 109 (Del. 2020) (evaluating a facial challenge to federal-forum provisions in corporate charters); ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554, 555 (Del. 2014) (evaluating "the validity of a fee-shifting provision in a Delaware non-stock corporation's bylaws"); Boilermakers Loc. 154 Ret. Fund v. Chevron Corp., 73 A.3d 934, 937-38 (Del. Ch. 2013) (evaluating a challenge to forum selection provisions in corporate bylaws).

[310] *See infra* Appendix.

[311] Sample policies from the companies listed in the Appendix are on file with the author.

Example 1. Disclosure of Drafter/Approver[312]



POLICY DOCUMENT

AMERICAN WATER

Insider Trading and Prohibited Transactions Policy

Policy Number: POL-LEG01

Applicability: American Water Works Company, Inc. and its subsidiaries

Effective Date: 10/24/2022

ELT Sponsor: Executive Vice President and General Counsel

Document Author: Vice President, Chief SEC Counsel and Secretary

Example 2. Disclosure of Amendment History[313]

APPROVALS

REVISION HISTORY

Rev.	Date	Description
A	3/02/06	Restrictions clarified and policy updated
B	12/7/06	Restrictions clarified and policy updated
C	11/21/14	Pledging and hedging prohibitions added. FAQs added
D	09/14/17	Title revisions
E	9/29/20	Restrictions clarified and policy updated
F	11/10/20	Increased time for market absorption of information from 1 to 2 full days
G	03/26/21	Clarifies expectation that all people subject to trading blackout provisions must seek pre-clearance for any trade
H	10/20/2022	Incorporates changes agreed to in final agreement

Second, an internal oversight mechanism over policy content is necessary. The content of corporate policies centers on the internal procedural mechanism on how to review and approve "specific actions" (e.g., trading of stock, or transaction). Still, it rarely provides information about the internal procedure for overseeing the "policy content" to maintain its quality. For instance, if a policy already contains a provision circumventing external laws, there should be an

[312] AM. WATER, INSIDER TRADING AND PROHIBITED TRANSACTIONS POLICY 1 (2022), https://s26.q4cdn.com/750150140/files/doc_downloads/governance/2022/Insider-Trading-and-Prohibited-Transactions-Policy-10242022.pdf [https://perma.cc/CYC3-Z7FE].

[313] BORGWARNER, INSIDER TRADING AND CONFIDENTIALITY POLICY 5 (2022), https://www.borgwarner.com/docs/default-source/investors/corporate-governance/insider-trading-policy.pdf?sfvrsn=3 [https://perma.cc/J96N-NJDE].

internal procedure to remedy the problem. Corporate policies rarely provide information about who can challenge, if ever, the policy content within a company.[314] Also, whether drafters or approvers of the problematic policy will be subject to internal discipline is unclear. As the SEC is less likely to challenge the adequacy of policy content when the policies are properly disclosed,[315] the content can be better monitored by corporate constituents who may be better informed of their company's unique circumstances, including independent directors on the board. Thus, shareholders can have a critical role in maintaining the quality of corporate policies.

Third, to secure the upward information flow within the company, companies should not waive disclosure obligations from employees to companies in their corporate policies. Even when a corporate insider wields her screening authority for efficiency, at least she has to keep the list of the approved transactions available for possible *ex post* review by an independent board committee in order to avoid a potential information blackout.[316] Similarly, when related party transactions are deemed pre-approved, employees still need to submit the list of pre-approved transactions to an internal authority, and the authority needs to keep the list available for the potential *ex post* review.

[314] *See, e.g.*, APPLE INC., AUDIT AND FINANCE COMMITTEE CHARTER 7 (2020), https://s2.q4cdn.com/470004039/files/doc_downloads/charters/20200819-Audit-and-Finance-Committee-Charter.pdf [https://perma.cc/NF4E-MW75] ("46. Review and approve related-party *transactions* consistent with the Related Party Transactions Policy and report to the full Board on any approved transactions" (emphasis added)); APPLE INC., RELATED PARTY TRANSACTIONS POLICY 1 (2017) ("The Board has determined that the Audit and Finance Committee . . . of the Board is best suited to review and approve all Interested *Transactions* with Related Parties" (emphasis added)), https://s2.q4cdn.com/470004039/files/doc_downloads/gov_docs/2017.08.29_Related_Party_Transactions_Policy.pdf [https://perma.cc/AJG5-VN5Y].

[315] *See* Executive Compensation and Related Person Disclosure, 71 Fed. Reg. 53158, 53253 (Sept. 8, 2006) (codified at 17 C.F.R. pts. 228-29, 232, 239-40, 245, 249 and 274) (explaining "the material features of such policies and procedures will vary depending on the particular circumstances").

[316] *See* Martinez, *supra* note 22, at 272, 275.

2. Shareholders

The next policy proposal focuses on shareholders' role in *ex ante* supervision and *ex post* remedy for inoperative corporate policies.[317] The effectiveness of customized compliance largely depends on securing information flow.[318] In order to evaluate whether a corporate policy is well-functioning and who should be held accountable for compliance failures, having access to the policies is a necessary condition. In that light, this Subsection proposes two information-gathering mechanisms for shareholders.

a. Shareholder Proposals

Shareholder proposals have emerged as a crucial information channel to obtain internal corporate information from management,[319] as the board's unresponsiveness to shareholder proposals can invite negative votes for a director election in the following year.[320] Shareholder proposals are an effective way to monitor the content of corporate policies,[321] especially when they make it to the voting stage.[322] In a series of cases, however, the SEC decided that shareholder proposals concerning "adherence to ethical business practices and the conduct of legal compliance programs" are generally excludable under rule 14a-

[317] *See generally* Lipton, *supra* note 208, at 681-92 (arguing that corporate regulatory systems "can construct shareholders and guide their preferences").

[318] *See supra* Part II.C.2.

[319] *See supra* Part I.A.2.

[320] *Id.*

[321] *See* Haan, *supra* note 20, at 272 ("Social and environmental proposals . . . seek to reform corporate social and environmental policies on a range of topics that involve third-party interests . . . .").

[322] *Cf.* Shareholders proposal settlements between a shareholder and a company can also affect corporate policies, even though the shareholder proposal is withdrawn before shareholder voting. *Id.* at 300 ("Settlement may look particularly attractive to the proponent of a social or environmental proposal because settlement minimizes costs that are poorly offset by far-off or hard-to-quantify social or environmental gains.").

8(i)(7) (ordinary business matters),[323] as shareholders generally do not have a say in ordinary business operations.[324]

However, shareholder proposals on compliance issues may be entering a new phase. On November 3, 2021, the SEC Division of Corporate Finance issued Staff Legal Bulletin (SLB) 14L,[325] which provides a significant social policy exception. This exception allows the SEC staff to "consider whether the proposal raises issues with a broad societal impact, such that they transcend the ordinary business of the company."[326] And on March 8, 2022, the SEC staff denied no-action letter relief to Pfizer Inc.'s attempt to exclude a shareholder proposal requesting a report on the board's (or board committee's) oversight responsibility for risks related to anti-competitive practices, stating that the proposal raises issues that "transcend ordinary business matters."[327]

Pfizer's argument for excluding the proposal relied on the prior no-action letters that consistently confirmed compliance issues are ordinary business matters, and Pfizer also relied on the SEC's 1998 Release[328] that specifically identified a shareholder proposal that "seeks to impose specific time-frames or methods for implementing complex policies" as an example of an excludable, micromanaging proposal.[329] Nevertheless, the SEC staff did not concur with Pfizer, and the proposal

[323] Sprint Nextel Corp., SEC No-Action Letter, 2010 WL 4922499, at *1 (Mar. 16, 2010); *see also* Raytheon Co., SEC No-Action Letter, 2013 WL 477120, at *1 (Mar. 25, 2013) ("Proposals that concern a company's legal compliance program are generally excludable under Rule 14a-8(i)(7)."); Verizon Commc'ns Inc., SEC No-Action Letter, 2008 WL 82542, at *1 (Jan. 7, 2008) (noting that the shareholder proposal requesting the implementation of policies to prevent the company's illegally trespass on private property is relating to Verizon's "ordinary business operations (i.e., general legal compliance program)" and excludable under Rule 14a-8(i)(7)).

[324] Typically, a company can exclude a shareholder proposal from its proxy materials only when the SEC grants a no-action letter relief based on 13 grounds specified in the SEC Rule. 17 C.F.R. § 240.14a-8(i)(1)-(13) (2023).

[325] SEC Staff Legal Bulletin No. 14L, 2021 WL 5415213 (Nov. 3, 2021).

[326] *Id.*

[327] Pfizer Inc., SEC No-Action Letter, 2021 WL 6126555, at *1-2 (Mar. 8, 2022).

[328] Amendments to Rules on Shareholder Proposals, 63 Fed. Reg. 29106 (May 28, 1998) (codified at 17 C.F.R. pt. 240).

[329] *Id.* at 29108-09; *see* Pfizer Inc., *supra* note 327 at 2-3.

was voted on.[330] Again, three days later, it did not allow AbbVie Inc. to exclude a shareholder proposal about an identical issue.[331] The SEC did not explicitly articulate how it changed its prior approach to compliance issues, but based on recent letters, the SEC seems to acknowledge that compliance issues have a social impact that *transcends* ordinary business. Therefore, more shareholder proposals seeking information about compliance issues will likely go up for a shareholder vote, which, in turn, exerts more pressure on the board.

b. Shareholder Inspection Rights

To obtain undisclosed corporate policies, shareholder inspection rights can also be a valuable channel.[332] As the Delaware Supreme Court lowered the bar to use the right by ruling that a shareholder plaintiff seeking a Section 220 demand is not required to establish that the corporate misconduct being investigated is actionable,[333] shareholders can demand corporate policies sooner, even before the violation occurs.

3. Regulators: The SEC

The SEC has been expanding disclosure requirements for corporate policies over the last few years, yet useful guidelines are still lacking.[334] As discussed earlier, the current practice of S&P 500 companies' corporate policies has revealed room for improvement. Given the SEC's

[330] The shareholder proposal was not approved. *See* Pfizer Inc., Current Report (Form 8-K) (May 2, 2022).

[331] AbbVie Inc., SEC No-Action Letter, 2021 WL 6126539, at *1 (Mar. 11, 2022) (noting that the proposal "raises issues that transcend ordinary business matters").

[332] *See, e.g.*, DEL. CODE ANN. tit. 8, § 220(b) (2023). One vivid battleground for internal corporate information between shareholders and directors is statutory shareholder inspection rights action. *See* James D. Cox, Kenneth J. Martin & Randall S. Thomas, *The Paradox of Delaware's "Tools at Hand" Doctrine: An Empirical Investigation*, 75 BUS. LAW. 2123, 2125 (2020); George S. Geis, *Information Litigation in Corporate Law*, 71 ALA. L. REV. 407, 410, (2019); Huang & Thomas, *supra* note 307, at 909; Geeyoung Min & Alexander M. Krischik, *Realigning Stockholder Inspection Rights*, 27 STAN. J.L. BUS. & FIN. 225, 229-300 (2022); Roy Shapira, *Corporate Law, Retooled: How Books and Records Revamped Judicial Oversight*, 42 CARDOZO. L. REV. 1949, 1952, 1954-55 (2021).

[333] AmerisourceBergen Corp. v. Lebanon Cnty. Emps.' Ret. Fund, 243 A.3d 417, 421 (Del. 2020).

[334] *See supra* Part II.

principle-based approach,[335] detailed instructions on what should be included in corporate policies may not be necessarily desirable to maintain the flexibility of private ordering,[336] but it may still be beneficial to provide more guidance on what should *not* be included in corporate policies.

For example, the prevalent use of categorical waivers for related party transactions is likely encouraged by the SEC's rule stating: "(i) the types of transactions that are covered by [a company's] policies and procedures" as an exemplary feature.[337] Many companies flip the rule, and proactively list the types of transactions that are *not* covered by their policy, resulting in categorical waivers.[338] The SEC needs to issue guidance[339] on the prevalent misuse of categorical exclusions because the current practice of private ordering in corporate policies undermines the SEC's principle-based approach.[340] For instance, related party transaction policies that waive disclosure requirements beyond the SEC's enlisted exceptions would violate the SEC rule.[341] The rule explicitly prohibits companies from waiving the *disclosure* requirements, while allowing the waiver of the *review or approval* process.[342] The limits of private ordering in corporate compliance are not easy to establish,[343] but the effort to clarify them is long overdue.

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[335] *See* Executive Compensation and Related Person Disclosure, 71 Fed. Reg. 53157, 53197 (Sept. 8, 2006) (codified at 17 C.F.R. pts. 228-29, 232, 239-40, 245, 249 and 274).

[336] For instance, corporate policies should *not* be tailored to be incongruent with external regulations in the same way that categorical inclusions and exclusions did.

[337] 17 C.F.R. § 229.404(b)(1)(i) (2023).

[338] Altering the default in a more management-friendly way is not an uncommon tactic in corporate contracts. *See* Ian Ayres, *Regulating Opt-Out: An Economic Theory of Altering Rules*, 121 YALE L.J. 2032, 2034-36 (2012); Yair Listokin, *What Do Corporate Default Rules and Menus Do? An Empirical Examination*, 6 J. EMPIRICAL LEGAL STUD. 279, 283 (2009).

[339] *See* Nicholas R. Parrillo, *Federal Agency Guidance and the Power to Bind: An Empirical Study of Agencies and Industries*, 36 YALE J. ON REGUL. 165, 167-68 (2019); David T. Zaring, *Best Practices*, 81 N.Y.U. L. REV. 294, 295 (2006).

[340] *See supra* Part II.C.2.

[341] *See* 17 C.F.R. § 229.404(b)(2) (2023).

[342] *See supra* Part II.B.1.

[343] An insightful and thorough analysis of the limits of private ordering in corporate governance is generally applicable to private ordering in corporate compliance. *See* Fisch, *Stealth Governance*, *supra* note 28, at 923-26.

4. Enforcement Authorities: The DOJ

The DOJ guidelines on compliance programs have significantly shaped the contents of corporate policies.[344] However, the DOJ guidelines do not consider disclosure of corporate policies as a factor of good compliance programs.[345] Accordingly, many companies still tend to keep their stand-alone corporate policies internally, making them available only to their employees.[346] Thus, if the DOJ adds a disclosure of corporate policies as a component of a good compliance program, allowing companies to secure more credits in the enforcement process, this will provide a significant incentive to companies to improve the quality of their policies.

CONCLUSION

Corporate policies have emerged as the next frontier of private ordering in corporate compliance, and companies wield significant contractual discretion in implementing corporate policies. Despite the magnitude of corporate policies' influence over actors inside and outside of corporations, there have not been enough checks on these policies. In light of the rapid expansion of corporate compliance by private ordering, this Article uncovers novel trends in practice and advances the concept of strategic compliance, emphasizing the key role of external enforcement in shaping internal corporate policies. Furthermore, the Article offers useful policy recommendations aimed at maximizing the benefits of customization while minimizing the potential risks of undermining external regulations.

344 *See supra* Part I.A.1.

345 *See* EVALUATION OF CORPORATE COMPLIANCE PROGRAMS, *supra* note 13, at 2-8.

346 S&P 500 companies often include links to stand-alone insider trading policies in their code of ethics, but you have to go through the employee portal to access them.

APPENDIX

Insider Trading ("IT") Policies (Collected between Oct. 23-27, 2022)

ID Number	**Company Name**	**Scope of Trading Prohibition**	**Effective Date**
1	ALLSTATE	**Any other** company's stock	7/8/2022
2	A. O. SMITH	**Any other** company's stock	March 2020
3	AMERICAN ELECTRIC POWER	**Any other** company's stock	Not Dated
4	AMERICAN WATER WORKS	**Any other** company's stock	10/24/2022
5	AON	**Any other** company's stock	10/1/2021
6	APTIV	Employer's stock **and** its business partners' and competitors' stock	August 2022
7	ATMOS ENERGY	**Any other** company's stock	August 2021
8	AUTOMATIC DATA PROCESSING	Employer's stock **and** its business partners' and competitors' stock	4/6/2022
9	BAXTER INTERNATIONAL	**Any other** company's stock	6/7/2019
10	BERKSHIRE HATHAWAY	**Any other** company's stock	Not Dated
11	BOOKING HOLDINGS	**Any other** company's stock	11/1/2021
12	BORGWARNER	Employer's Stock Only	10/20/2022
13	BROADRIDGE FINANCIAL SOLUTIONS	**Any other** company's stock	2/15/2022
14	CAMPBELL SOUP	**Any other** company's stock	February 2019
15	CATALENT	**Any other** company's stock	1/29/2020
16	CF INDUSTRIES HOLDINGS	**Any other** company's stock	Not Dated
17	CHARLES RIVER LABORATORIES INTERNATIONAL	**Any other** company's stock	7/14/2021
18	COPART	**Any other** company's stock	Not Dated
19	DARDEN RESTAURANTS	Employer's stock **and** its business partners' and competitors' stock	10/1/2021
20	DUKE ENERGY	**Any other** company's stock	Not Dated
21	DUKE REALTY	Employer's stock **and** its business partners' and competitors' stock	Not Dated

22	ELEVANCE HEALTH	**Any other** company's stock	6/28/2022
23	F5	**Any other** company's stock	Not Dated
24	FLEETCOR TECHNOLOGIES	**Any other** company's stock	10/22/2019
25	FOX	Employer's stock **and** its business partners' and competitors' stock (should contact to verify)	Not Dated
26	FREEPORT-MCMORAN	Employer's stock **and** its business partners' and competitors' stock	May 2020
27	GENERAL MOTORS	**Any other** company's stock	8/14/2018
28	HERSHEY	**Any other** company's stock	12/13/2021
29	HORMEL FOODS	**Any other** company's stock	January 2019
30	HOWMET AEROSPACE	**Any other** company's stock	June 2020
31	HUMANA	**Any other** company's stock	December 2015
32	J. B. HUNT TRANSPORT SERVICES	Employer's Stock Only	1/22/2020
33	LINCOLN FINANCIAL	**Any other** company's stock	11/10/2021
34	LKQ	**Any other** company's stock	8/11/2020
35	MGM RESORTS INTERNATIONAL	**Any other** company's stock	8/21/2019
36	MICROCHIP TECHNOLOGY	Employer's stock **and** its business partners' and competitors' stock	Not Dated
37	NETFLIX	**Any other** company's stock	2/28/2022
38	NEWS CORP	Employer's stock **and** its business partners' and competitors' stock	March 2021
39	NXP SEMICONDUCTORS	Employer's stock **and** its business partners' and competitors' stock	March 2022
40	POOL CORPORATION	**Any other** company's stock	Not Dated
41	PULTEGROUP	**Any other** company's stock	5/9/2019
42	RESMED	**Any other** company's stock	May 2022
43	SKYWORKS SOLUTIONS, INC.	**Any other** company's stock	October 2022
44	SOLAREDGE	**Any other** company's stock	11/30/2021
45	STRYKER CORPORATION	Employer's stock **and** its business partners' and competitors' stock	Not Dated

46	TELEDYNE TECHNOLOGIES	**Any other** company's stock	4/29/2022
47	TRACTOR SUPPLY	**Any other** company's stock	11/3/2022
48	TRIMBLE INC.	**Any other** company's stock	Not Dated
49	UDR, INC.	Employer's stock **and** its business partners' and competitors' stock	5/27/2021
50	UNIVERSAL HEALTH SERVICES	**Any other** company's stock	2/27/2020
51	VERISK ANALYTICS	Employer's stock **and** its business partners' and competitors' stock	2/17/2021

Related Party Transaction ("RPT") Policies (Collected between Oct. 23-27, 2022)

ID Number	COMPANY Name	Categorical Exclusions: Non-RPTs	Categorical Exclusions: Pre-Approved RPTs	Effective Date
1	ACTIVISION BLIZZARD	11	0	2/2/2016
2	ALLEGION	0	0	2/6/2020
3	ALLSTATE	7	0	7/12/2021
4	ALTRIA GROUP	6	0	Not Dated
5	AMEREN	5	1	2/9/2018
6	AMERICAN ELECTRIC POWER	1	0	2/28/2012
7	AMERICAN INTERNATIONAL GROUP	6	0	2/14/2014
8	AMERICAN WATER WORKS	8	0	8/1/2021
9	AMERISOURCEBERGEN	0	7	8/5/2015
10	ANALOG DEVICES	7	0	Not Dated
11	AON	0	0	6/24/2021
12	APPLE	0	6	8/18/2020
13	AT&T	0	0	11/5/2021
14	AUTOMATIC DATA PROCESSING	8	0	Not Dated
15	BATH & BODY WORKS	10	0	9/8/2021
16	BECTON DICKINSON & CO.	2	0	9/28/2010
17	BROADRIDGE FINANCIAL SOLUTIONS	0	9	5/12/2022

18	CADENCE DESIGN SYSTEMS	0	7	May 2019
19	CAMPBELL SOUP	0	9	11/17/2016
20	CARMAX	2	0	1/22/2007
21	CARRIER GLOBAL	0	7	2/4/2021
22	CBRE GROUP	0	1	5/18/2018
23	CHARLES RIVER LABORATORIES	7	0	2/9/2007
24	CITIGROUP	0	6	6/22/2020
25	CME GROUP	0	8	11/3/2021
26	COMCAST	0	8	4/15/2019
27	CONSTELLATION ENERGY	2	0	2/1/2022
28	DAVITA INC.	0	0	3/1/2007
29	DOMINION ENERGY	7	0	5/10/2017
30	DOVER CORP.	8	0	11/4/2021
31	DUKE ENERGY	1	0	Not Dated
32	DXC TECHNOLOGY	0	0	Not Dated
33	EVERSOURCE ENERGY	3	0	Not Dated
34	EXELON	3	0	9/25/2019
35	EXXON MOBIL	0	4	4/30/2014
36	F5	0	0	Not Dated
37	FASTENAL	4	0	January 2007
38	FLEETCOR TECHNOLOGIES	0	7	11/29/2010
39	FMC CORPORATION	4	0	12/7/2007
40	GARMIN	7	0	October 2021
41	GENERAL MOTORS	6	0	12/7/2021
42	GLOBE LIFE INC.	2	0	October 2006
43	HERSHEY CO.	0	0	12/13/2021
44	HONEYWELL INTERNATIONAL	0	0	2/4/2019
45	HORTON D R INC.	0	0	12/17/2019
46	HOWMET AEROSPACE	0	11	September 2013
47	HUMANA	0	0	2/22/2007
48	INTERNATIONAL FLAVORS & FRAGRANCES	2	0	January 2022
49	INTERNATIONAL PAPER	5	0	12/14/2021
50	JOHNSON & JOHNSON	0	8	Not Dated
51	KELLOGG	0	0	1/30/2007
52	KEYCORP	4	0	9/18/2013

53	KEYSIGHT TECHNOLOGIES	0	3	10/30/2014
54	L3HARRIS TECHNOLOGIES	8	0	6/29/2019
55	LKQ CORP.	0	0	Not Dated
56	LOCKHEED MARTIN	0	10	9/23/2021
57	MARATHON PETROLEUM	7	0	Not dated
58	MASCO CORPORATION	8	0	July 2009
59	MOHAWK INDUSTRIES	0	0	Not Dated
60	MOLINA HEALTHCARE	0	0	Not Dated
61	MOSAIC	8	0	3/1/2020
62	NETAPP	0	7	September 2016
63	NORDSON CORPORATION	0	8	Not dated
64	NORTHROP GRUMMAN	9	0	12/18/2021
65	OTIS WORLDWIDE	0	7	4/3/2020
66	PACKAGING CORPORATION OF AMERICA	0	0	2/28/2007
67	PAYCOM SOFTWARE	8	0	Not Dated
68	PENTAIR	2	0	9/21/2021
69	PFIZER	0	7	December 2018
70	PHILIP MORRIS INTERNATIONAL	7	0	Not Dated
71	PROCTER & GAMBLE	0	9	Not Dated
72	PRUDENTIAL FINANCIAL	7	0	9/8/2015
73	RAYTHEON TECHNOLOGIES	0	8	4/29/2019
74	RESMED	0	6	8/20/2021
75	ROCKWELL AUTOMATION	9	0	11/1/2007
76	SEALED AIR CORP	0	7	2/12/2020
77	STEEL DYNAMICS	0	5	Not Dated
78	TELEDYNE TECHNOLOGIES	0	5	7/24/2007
79	THE TRAVELERS COMPANIES	1	0	12/13/2006
80	UDR	0	0	7/22/2021
81	UNITED PARCEL SERVICE	0	9	2/10/2022

82	UNITED RENTALS	8	0	10/24/2019
83	UNITEDHEALTH GROUP	7	0	11/4/2021
84	UNUM GROUP	0	6	5/25/2016
85	US BANCORP	7	0	10/20/2015
86	VALERO ENERGY	0	7	3/15/2022
87	VERISK ANALYTICS	8	0	8/19/2009
88	VICI PROPERTIES	0	3	2/16/2022
89	WALGREENS BOOTS ALLIANCE	0	4	12/9/2020
90	WELLS FARGO	8	0	1/24/2022
91	WEST PHARMACEUTICAL SERVICES	0	7	10/7/2011
92	WESTERN UNION	5	0	12/9/2009
93	WESTINGHOUSE AIR BRAKE TECHNOLOGIES	0	4	1/18/2021
94	WEYERHAEUSER	0	0	Not Dated
95	WHIRLPOOL	0	0	12/19/2006
96	WILLIAMS COMPANIES	0	0	10/25/2020
97	WILLIS TOWERS WATSON	9	0	May 2019
98	XCEL ENERGY	4	0	8/19/2020
99	ZEBRA TECHNOLOGIES	8	0	11/1/2019
100	ZIONS BANCORPORATION	3	0	Not Dated
101	ZOETIS	0	8	5/15/2019