Title
The Ethics of In-House Practice

Journal
UCLA School of Law Public Law & Legal Theory Series

Author
Kim, Sung Hui

Publication Date
2011-08-30

CHAPTER TEN

The Ethics of In-House Practice

Sung Hui Kim

For nine years, Oliver Budde served as an associate general counsel at Lehman Brothers, a venerable investment bank. As is typical of many lawyers employed in corporations ("inside counsel" or "inside lawyers"),[1] Budde first served six grueling years as an associate in a prestigious law firm before joining the bank. Initially, he enjoyed the work at Lehman Brothers. Budde recalled, "It was a job I was proud of. There was no 'ick' factor, at least at first" (Sterngold 2010). But things got more "icky" after just a few years. On one occasion, Lehman's outside accounting firm had proposed to lower medical insurance costs through the use of a questionable tax transaction. Budde openly objected. He noted, "My gut feeling was that this was just reshuffling some papers to get an expense off the balance sheet. . . . It was not the right thing, and I told them." But Budde's superiors in Lehman's general counsel's office disagreed, and the deal went through.

Worse, Budde noticed that Lehman was not transparently reporting its executive compensation in its filings with the Securities and Exchange Commission (SEC). Budde thought that Lehman's disclosure strategy, while not clearly prohibited, was too aggressive and misled public investors about how much Lehman was paying its senior executives. Budde complained to his superiors but was told that the bank's outside attorneys at the law firm of Simpson, Thacher & Bartlett had blessed the strategy.

Exasperated by Lehman's grudging attitude toward compliance, Budde eventually quit in 2006. Later, Budde discovered that Lehman continued with

I thank Jerry Kang, Robert Rosen, Tanina Rostain, and the editors, Leslie Levin and Lynn Mather, for helpful comments.

1. Inside lawyers are also commonly referred to as in-house or corporate counsel.

its disclosure approach even after SEC releases made clear that doing so would be improper. Of course, we now know that securities compliance was just one of a myriad of problems afflicting Lehman at that time. In 2008, Lehman Brothers collapsed in the largest bankruptcy in US history.

The tensions that Budde faced should ring familiar to many inside lawyers working in legal departments throughout corporate America. Once viewed as the quality-of-life refuge from private practice, the in-house position is now recognized as "among the most complex and difficult of those functions performed by lawyers" (Hazard 1997, 1011). One reason why the position is so complex and difficult is the ambiguity and internal contradiction in inside counsel's job description. On the one hand, inside counsel are intentionally carved into the corporate decision-making process to constrain managerial discretion and safeguard the company from legal trouble. Accordingly, inside counsel often have direct responsibility over compliance and are expected to intervene when significant legal risks are at stake. On the other hand, inside counsel are often regarded as mere "advisers" and thus remain subordinate to managerial prerogatives—even with respect to serious legal risks. On this view, inside counsel are expected to defer to business management at whose pleasure they serve.[2] This latter view is consistent with the conventional skepticism about inside counsel's willingness to check corporate misconduct (DeMott 2005, 967). This chapter explores how inside counsel negotiate these dueling job descriptions by analyzing the existing empirical literature.

Before examining how inside counsel perform their jobs, we need a basic understanding about who these lawyers are. There are approximately 65,000 inside counsel in the United States, working in about 21,000 non- and for-profit organizations, reflecting approximately 8 to 10% of the bar (Carson 2004; Hackett 2002, 610, 618). Most inside counsel work not in large, but small, corporate legal departments or as sole inside counsel for their companies.[3] One large-scale survey reported that the median and the mean of inside attorneys employed in corporate legal departments were just ten and six, respectively (Hackett 2002, 610). Most inside counsel moved in-house after working in private law firms for (on average) six years (618). The most common industries in

2. Most in-house general counsel (61.4%) report to their companies' chief executive officer. A minority report to another senior executive (e.g., the president or chief financial officer). Most inside counsel are physically stationed together in the corporation's central office, reporting up the ladder to the general counsel, as opposed to being stationed in various operating divisions and reporting directly to the head of the local operating unit (Hackett 2002, 612).

3. Many Fortune 500 companies have small law departments (defined as being less than 15 persons) but very large legal budgets (Hackett 2002, 613).

which inside counsel work are manufacturing (27.0%), finance and insurance (19.3%), and information (7.5%) (619). The most common areas of practice are general corporate transactions, general matters, general commercial law, intellectual property, and employment/human resources (611).

Since the 1970s, inside counsel have enjoyed increased visibility and stature (Liggio 1997). Due to the increase in business-to-business litigation, the proliferation of administrative regulations, and the exponential growth in legal costs (1203–1204), CEOs have grown to rely more on their in-house legal staffs and less on outside law firms for corporate legal advice. Accordingly, the balance of power has shifted from outside to inside counsel. To be sure, outside law firms remain important and perform the bulk of the litigation for companies in litigious industries (Hackett 2002, 613). Their influence is filtered, however, through inside counsel who monitor their performance and actively manage law firms' delivery of legal services to corporations.

But it is not just the increased stature of in-house legal staffs that justify the study of inside counsel. Inside lawyers' acts and omissions are often critical components of corporate misbehavior. What's more, inside lawyers are in many ways better situated than outside lawyers to prevent corporate malfeasance. This is true for at least two reasons. First, inside counsel are more likely to confront potential corporate misconduct. In their "preventive law" role (Brown 1950; Gruner 1997), inside counsel ordinarily manage corporate compliance programs to ensure that the company minimizes the risk of legal liability. In a recent survey of general counsel of Standard & Poor's 500 companies, 81% indicated that they oversaw compliance (Beardslee et al. 2010). In performing this formal role, they are likely to learn of instances of intentional or negligent noncompliance. Also, due to their physical proximity to those who hold information about misconduct (i.e., coworkers), inside lawyers normally have access to informal, back-channel information (Hazard 1997) that may contain the critical indicators of incipient, ongoing, or completed corporate misconduct.

Second, inside counsel are better situated to interpret the information they receive. Inside counsel understand what Robert Rosen (2010, 59) has described as the "bureaucratic pathologies [that] are commonplace in corporate legal practice": for example, why this manager insists that his project go through, why that manager favors the instant customer at corporate expense, and why business units obsess about their short-term balance sheets at the expense of the long-term business (59–60). In short, inside counsel have a better developed "spider sense," as cultivated by an intimate familiarity with the political landscape of the firm and well-practiced situational judgment (Kim 2008). By contrast, outside counsel are often privy to only filtered fragments of larger problems and are thus inherently limited in their ability to detect potential malfeasance. In sum, inside counsel play a crucial role in facilitating or preventing corporate misbehavior—which makes them significant targets of research and inquiry (Kim 2005).

What, then, do we know about how these lawyers actually play this role? How do inside lawyers approach their dueling job descriptions? Do they merely offer legal advice and punt the final decision to the business manager, as the conventional wisdom suggests? Or do they more proactively use their powers of persuasion to steer the company's agenda? Do they intervene in purely business matters, or do they keep it "strictly legal"? What do inside counsel do when they observe a fellow employee engaged in improper conduct that might harm the corporation? Do they intervene, or do they turn a blind eye and "see no evil, hear no evil"?

To organize these inquiries, I draw on the American Bar Association's (ABA) Model Rules of Professional Conduct. The Model Rules provide a baseline framework for what constitutes appropriate lawyer conduct (at least according to the ABA). Although Model Rule compliance hardly guarantees "ethical" behavior from any or all moral foundations, such compliance provides a useful benchmark of behavior deemed "ethical" according to the positive law. In addition, using the Model Rules as a reference point facilitates an understanding of how lawyers themselves define what is an appropriate professional response. This is not to say that lawyers have internalized (let alone, even recall) the specific disciplinary rules (Abel 1989, 143). But without the use of a uniform benchmark, it would be extremely difficult to compare the findings generated from the various empirical studies (Chambliss, chapter 3).

I rely primarily on Model Rule 1.13 (Organization as Client) to develop an analytical framework with which to evaluate the empirical research. Although the rule applies to both inside and outside lawyers representing organizations, it provides especially important guidance for lawyers working in-house, who, for the reasons described above, are more likely to encounter the situations contemplated by the rule. After explaining Model Rule 1.13 and my theoretical framework, I review the existing empirical research on inside counsel[4] to

4. The main studies focusing on inside counsel that I draw on are (1) John Donnell's study (1970) of 16 counsel and 18 client representatives of three large companies from three different

determine whether and to what degree inside counsel's behavior conforms to the Model Rules.

Model Rules of Professional Conduct: Organization as Client

Clarifying the Client

Inside counsel faced with managers who want to break the law must remind themselves who the client is. Model Rule 1.13(a) makes the crucial threshold clarification—that "a lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents." Thus, the client is the *organization*, a term that includes corporations and other business associations. Accordingly, the in-house lawyer for an organization does not represent the organization's *constituents*, who include corporate officers, directors, employees, and shareholders.

Of course, the "organization" is a legal fiction that functions only through flesh-and-blood actors. Therefore, in practice, lawyers psychologically suspend this fiction and interact with the organization's "duly authorized constituents," *as if* they were the clients. For inside lawyers, these constituents are the senior corporate officials (the corporate directors and officers) and their delegatees, typically mid- to high-level business managers. Normally, these businesspersons are vested with the authority to act as the client's mouthpiece for purposes of soliciting corporate legal advice.

Reporting Up the Ladder

But these constituents do not enjoy limitless authority. Those limits are suggested by Model Rule 1.13(b), which addresses cases in which an officer, employee, or other constituent violates "a legal obligation to the organization, or [violates] law that reasonably might be imputed to the organization, and that

---

industries; (2) Robert Rosen's study (2010) (conducted in the 1970s) of 77 informants (comprising inside counsel, business managers, and outside counsel) of six manufacturing firms; (3) Eve Spangler's study (1986) on the role of inside counsel in her larger study of salaried lawyers; (4) Robert Nelson and Laura Beth Nielsen's study (2000) of 86 informants (comprising inside counsel, legally trained executives, and nonlawyer executives) from 46 large corporations and financial institutions; (5) Hugh Gunz and Sally Gunz's questionnaire survey (2002) of 484 Canadian inside counsel; (6) Sally Gunz and Hugh Gunz's study (2008) of 25 Canadian inside counsel; (7) Tanina Rostain's pilot study (2008) of 10 general counsel at Fortune 1000 companies; and (8) Michele DeStefano Beardslee's study (2009) of inside counsel's role in public relations, surveying 125 general counsels, 8 external and internal public relations executives, and 10 law firm partners.

is likely to result in substantial injury to the organization." Examples include securities fraud or the marketing of dangerous products, which could lead to civil or criminal liability for the corporation (Hazard and Hodes 2005). When the lawyer for the organization "knows" about such a serious infraction and the matter is "related to the representation," then she must "proceed as is reasonably necessary in the best interest of the organization " (Model Rule 1.13(b)). The rule establishes a presumption that in such cases the lawyer "shall" report the matter to higher organizational authorities, including, "if warranted by the circumstances, to the highest authority that can act on behalf of the organization" (Model Rule 1.13(b)).

This internal reporting protocol is similar to the reporting rules applicable to counsel for public companies as a result of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). Those rules, codified at 17 C.F.R. pt. 205 (2010), require any lawyer "appearing and practicing before the [SEC] in the representation of the issuer" (including inside lawyers handling securities matters) to report any "evidence of material violation" of law to certain designated organizational officials and potentially to the board of directors, if necessary to ensure that appropriate measures are taken. Unlike the Model Rules, however, the lawyer is not invited to make any independent calculation regarding the best interest of the organization. In other words, the SEC has already determined that it is in the organization's best interest to report up any material law violations.

Reporting Out

What if the lawyer reports up to the board of directors, which then turns a blind eye? Model Rule 1.13(c) provides that when the board acquiesces in a "clear . . . violation of law" and "the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury"—then the lawyer *may* report even confidential information *outside* of the organization "to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization." The reporting *out* standard is more stringent than the reporting *up* standard: There must "clearly" be a violation of law, and the lawyer must be "reasonably certain" (as opposed to merely believing it "likely") that the organization will suffer substantial injury.

By vesting lawyers with the discretion to escalate matters not only up to but even outside the board, the Model Rules formally recognize that lawyers must sometime play the role of "gatekeeper"—an intermediary who prevents harm to the corporation by disrupting the misconduct of client representatives (Kim 2008).

Four Quadrants

Model Rule 1.13 is significant not only in its formal, literal application but also in its articulation, together with the comments, of a broader ethical roadmap. Comment 3 to Rule 1.13 provides important guidance:

> When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful. Decisions concerning *policy and operations*, including ones entailing *serious* risk, are not as such in the lawyer's *province*. Paragraph (b) makes clear, however, that when the lawyer knows that the organization is *likely* to be *substantially injured* by action of an officer or other constituent that *violates a legal obligation* to the organization or is in *violation of law* that might be imputed to the organization, the lawyer must proceed as is reasonably necessary in the best interest of the organization. (Emphasis added.)

Both the text of the rule and this comment highlight the relevance of two variables. First, violations of "law" and "legal obligation" are within the lawyer's "province"; by contrast, "policy and operations" are not. Accordingly, the Model Rules distinguish between legal and nonlegal (or business) domains or, more specifically, between unlawful and lawful (or at least not unlawful) actions. Second, Rule 1.13's various qualifiers about magnitude of harm (e.g., "substantial," "serious"), probability of occurrence (e.g., "likely"), and epistemological certitude (e.g., "reasonably certain") distinguish between what might be called material versus nonmaterial risks. If we intersect these two variables, we produce the four quadrants shown in table 10.1. These quadrants roughly categorize the situations that counsel to the organization are likely to face.

Quadrant I (Lawful Action; Immaterial Risk of Harm)

As a matter of common sense, courses of action falling under Quadrant I should pose the least concern for counsel. The Model Rules agree. As noted above, Comment 3 to Rule 1.13 makes clear that "decisions concerning policy and operations . . . are not as such in the lawyer's province." So long as the

Table 10.1. The Quadrants of Corporate Counseling

	Lawful Action	Unlawful Action
Immaterial Risk of Harm	Quadrant I	Quadrant III
Material Risk of Harm	Quadrant II	Quadrant IV

decision is not unlawful, the matter does not fall within the lawyer's decisional domain, and the lawyer must ultimately leave the matter for the businessperson to decide. For instance, if PepsiCo decides to phase out the Watermelon Ice flavor of its Gatorade line of sports drinks due to lagging sales, the legal department has no grounds to object.

To be sure, the Model Rules elsewhere point out that lawyers are not proscribed from giving advice beyond the legal domain. Indeed, Rule 2.1 states that a lawyer may also refer "to other considerations such as moral, economic, social and political factors that may be relevant to the client's situation." But this sentiment is hedged by the reminder that "a lawyer is not a moral advisor" (cmt. 2). Moreover, Comment 3 to Rule 2.1 indicates that a more deferential posture may be warranted when sophisticated clients are concerned: "A client may expressly or impliedly ask the lawyer for purely technical advice. When such a request is made by a client experienced in legal matters, the lawyer may accept it at face value."

Accordingly, the Model Rules permit lawyers to stick to "strictly legal" advice and leave the matter for the client (or client representative) to decide. This deference is reiterated in Rule 1.2's prescription that "a lawyer shall abide by a client's decisions concerning the objectives of representation" and the attendant observation that "lawyers usually defer to the client regarding . . . concern for third persons who might be adversely affected" by the legal representation (cmt. 2). Lest the lawyer harbor doubts about whether she, as a matter of professional ethics, may assist immoral (but not unlawful) conduct, Model Rule 1.2(b) clarifies that a lawyer's representation of a client "does not constitute an endorsement of the client's political, economic, social or moral views or activities." In sum, then, for Quadrant I matters, the Model Rules envision lawyers yielding to their clients in matters concededly lawful.

Quadrant II (Lawful Action; Material Risk of Harm)

What if the action is lawful, but the risk of harm is higher? Comment 3 to Rule 1.13 sticks to the same position: "Decisions concerning policy and operations, *including ones entailing serious risk*, are not as such in the lawyer's province" (emphasis added). As such, plans that are lawful even if they might financially ruin the company are classified by the Model Rules as *business* decisions. For example, if the Coca-Cola Company decides to change again its formula for Coke, its lawyer may advise against it, but then should defer to the company's business managers for the final decision.

Quadrant III (Unlawful Action; Immaterial Risk of Harm)

If the first two quadrants are deemed to be business decisions outside the lawyer's purview, one might assume that the next two (Quadrants III and IV)—because they both involve unlawful actions—would fall squarely within the lawyer's prerogative to stop. However, the Model Rules state otherwise for Quadrant III. Although counsel is free to try to dissuade an errant manager, the Model Rules require up-the-ladder reporting *only* when illegal conduct poses a risk of *substantial* harm to the corporation. By negative implication, illegal conduct posing an insubstantial risk of harm is excluded from the lawyer's formal gatekeeping jurisdiction. For example, underenforced regulatory violations or violations that risk nominal civil fines or agency warning letters (e.g., form violations of state bottled water labeling regulations) may fall in Quadrant III. Notwithstanding a lawyer's status as "officer of the court," the Model Rules have embedded within them thoroughly pragmatic accommodations. As such, a Quadrant III matter remains a business decision. That said, the Model Rules also clarify that any accommodation of the client must not transgress the norms against assisting a client's crime or fraud (Model Rule 1.2(d)).

Quadrant IV (Unlawful Action; Material Risk of Harm)

That leaves Quadrant IV, which encompasses unlawful actions that pose very serious risks to the organization. In this domain, the Model Rules grant the lawyer specific legal authority, indeed responsibility, to report up the ladder and, in narrow circumstances, to report out to law enforcement. For instance, if the CEO announced his intention to market defective kidney dialyzers, thus endangering the lives of nephrology patients (*Balla v. Gambro, Inc.*, 1991), counsel must report the matter to the board and *may* report out to enforcement agencies. Under the Model Rules, this would not be a mere business decision.

To recap, the Model Rules use two variables—lawfulness and materiality—to categorize the situations that might confront lawyers representing organizations. The Rules identify a single quadrant, Quadrant IV (unlawful action; material risk of harm), in which counsel must act as gatekeeper. If read less as positive law and more as normative pronouncements, the Rules sketch out a rough vision about the proper role for lawyers, including the appropriate zones of their activity and influence. Business matters (even those that might involve immoral but legally permissible conduct) are not "in the lawyer's province"; as such, lawyers may stick to the law and questions of legality (especially when dealing with sophisticated clients). Should the organization's actions potentially harm third-party interests, the Rules do not object to lawyers deferring to their clients. Even when faced with legal transgressions, counsel should ultimately defer to clients unless the risks are truly great. Arguably, the Rules subtly advocate a deferential posture as long as crimes or frauds are not abetted.

Seen in this way, the Model Rules accord with what has been called the "principle of nonaccountability" (Schwartz, 1978, 674), the "principle of neutrality" (Simon, 1978, 36), and the theory of "moral independence" (Painter, 1994, 557–560)—the view, long espoused by the American bar, that so long as lawyers are not abetting illegality, they are not morally responsible for their clients' ends, even if such ends are immoral or unjust. This disclaimer of lawyer accountability for the morality of clients' actions is one critical component of what has been called the "standard conception of the lawyer's role" (Postema 1980, 73). The "standard conception" excuses lawyers' aggressive pursuit of clients' ends, even if morally problematic, so long as such ends are not unlawful.

Empirical Findings

Of course, what the Model Rules say may have little bearing on what lawyers actually do. The empirical research on inside counsel shows the extent to which their self-reported behavior conforms with the Model Rules' vision of lawyering. Although critical questions remain unresolved, the research reveals general confirmation of the Model Rules' baseline.

Quadrants I and II: Empirical Confirmation

Matters falling in Quadrant I (lawful action; immaterial risk of harm) and Quadrant II (lawful action; material risk of harm) do not raise questions of legality. As such, whatever risks they pose, they are not legal risks. For such matters, the Model Rules require the lawyer to let the client decide. The empirical literature suggests that inside lawyers generally follow this instruction. Indeed, the inside counsel respondents in all the studies rarely challenged business managers' final authority to decide matters falling squarely within the business domain.

For example, in her pilot study of general counsel of Fortune 1000 companies, Tanina Rostain (2008) recounted how one general counsel described "the occasional request from managers to include provisions to indemnify particular customers in connection with certain sales" (475), a matter that is ordinarily viewed as a business decision.[5] Although this general counsel disagreed, as a matter of policy, with the decision to create a contractual obligation in favor of certain customers, "he often deferred to managers on this issue" (475).

But despite this general confirmation of the Model Rules, the studies also reveal that many inside counsel do not confine their involvement to matters that are "strictly legal," as the Rules permit. Indeed, many inside counsel participate actively in both Quadrant I and II decisions even though they pose no legal risk to the corporation. Even more interesting, these lawyers fall into two very different camps.

Entrepreneurs. In their study of inside counsel's lawyering styles conducted in the 1990s, Robert Nelson and Laura Beth Nielsen classified 33% of the 42 inside lawyers in their sample as "Entrepreneurs." Entrepreneurs embraced the business values in their work and, like the businesspeople, were motivated by financial gain and not just potential legal loss. They were proud of their ability to go beyond giving just legal advice. One general counsel of a holding company exemplified the typical entrepreneur:

> The chairman and chief financial officer consult me, as part of the strategic planning process that we go on. On matters outside of the legal function, I think probably because of the credibility I've gained in representing them over the last ten years in a variety of contexts, they've never expected, and we don't expect, our attorneys to limit their advice and input to pure legal advice. The client here has never found that to be the most valuable type of relationship. There are some clients that certainly expect the lawyers to limit their input to legal advice, but those folks have not succeeded well and don't represent the mainstream of our business management. (Nelson and Nielsen 2000, 466)

Nelson and Nielsen also observed that Entrepreneurs seemed to have greater influence on corporate activities than those lawyers who tended to narrow their concerns to strictly legal matters. In their case study of a major financial institution ("Alphacorp"), a separate component of their larger project, the authors observed that "the higher-ranked lawyers [were] more entrepreneurial than their subordinates" (2000, 481).

5. Ordinarily, including an indemnification provision in a contract is a legally unobjectionable course of action. As a result, the decision to add an indemnification obligation is normally viewed as a business decision to be finally decided by business managers.

Robert Rosen (2010) made similar observations in his study of inside counsel in six manufacturing firms in the 1970s. Rosen identified a group of inside counsel ("decision consultants") who often ventured into managerial domains and mixed business and legal advice (116). He noticed that these decision consultants exercised greater influence over corporate conduct than the other group of inside counsel ("risk analysts"), who confined themselves to legal risk analysis and played no meaningful part in corporate decision making (90).

Interestingly, Nelson and Nielsen (2000) observed that the entrepreneurial orientation of certain inside counsel influenced their approach to ethical issues. Instead of viewing the law as a constraint, Entrepreneurs saw the law as "a source of profits, an instrument to be used aggressively in the marketplace" to gain competitive advantages for their companies. As such, some "push[ed] the envelope in grey areas of the law," while others sought to legitimate their function by reference to economic values, "portray[ing] the law [to business executives] as adding value to the business, rather than only cost" (487). On the whole, Entrepreneurs discounted their role in policing management and emphasized their role in facilitating business deals and plans. In other words, Entrepreneurs who were active in Quadrant I and II matters displayed a tendency to minimize their gatekeeping role.

Counsel. As distinguished from Entrepreneurs, Nelson and Nielsen identified approximately 50% of the inside counsel sampled as "Counsel." These lawyers occasionally ventured beyond issues of legality to influence the outcome of business decisions. But their motivations differed from Entrepreneurs who emphasized business values. Instead, Counsel would pursue a particular course of action either because it was the morally right thing to do or it protected the company from reputational harm. Similarly, Canadian researchers Sally Gunz and Hugh Gunz (2008) identified a breed of inside counsel who "handle[d] decisions . . . by using his or her professional social capital to try to influence the behaviour of senior non-legal colleagues without playing the role of 'cop' " (930). Other researchers also described individual inside lawyers who exhibited characteristics resembling those of Counsel.[6]

One respondent classified as Counsel in Nelson and Nielsen's study (2000) described how he actively influenced certain decisions, including the proverbial "legal but stupid" decisions. This inside counsel clearly viewed his role as much more expansive than the conventional legal adviser:

6. For example, Donnell (1970) found inside lawyers' roles varied from "policeman" to "advisor," the latter being more similar to Nelson and Nielsen's Counsel.

> I believe that it's my role to make the decision and to make sure the business person goes along with it. Now that's contrary to everything I'd say on the outside or any general counsel would say, because we'd say, "It's not our role to make business decisions." We lay out the risks and the alternatives to our clients and then they make an informed business decision. Well, if they are making an informed business decision, in my mind there is only one decision they can make, the one I want them to make or I think they ought to make—because that's my job. I don't conceive it to be just laying out the risks, but I have to know enough about the company and enough about the situations and circumstances to weigh those risks. . . . [I]f I think they are doing something that is legal, that is stupid, it's my job to say to them, "That's stupid," or to convince them in such a way that they come around to my point of view, thinking it's their point of view. (465)

The mechanisms by which Counsel (or lawyers similar to Counsel) would intervene in Quadrants I and II varied. Sometimes, they directly employed moral suasion to influence business decisions. For example, one outside lawyer described an inside lawyer's superior ability to raise fairness concerns in a situation where no legal obligation had existed:

> The client wanted to know if he had to pay the debt. I found that the statute of limitations had run and that there was no legal requirement. I had known the client for a while and we talked about what was fair. He left wondering whether it was a waste of corporate resources to pay. The inside counsel then talked to him about just what the debtee had done for the company. He was needed to convince the client that in light of all the circumstances, it was proper to pay. I just couldn't do that. (Rosen 2010, 127)

More often, Counsel would raise ethical issues indirectly, by appealing to the firm's long term or reputational interests. For example, they may refer to potential jury reaction as a proxy for ethical concerns. Although Eve Spangler (1986, 92–93) did not classify the lawyers she interviewed for her study, she described how one inside counsel for an insurance company deployed predictable jury reaction and financial impact to great effect:

> My observation after fifteen years here [is that] if I said to a claims person, "As a legal matter you can raise the defense that you want to raise. But as a practical matter, if you go before a jury with that technical type defense [against] a poor disabled guy, out of work, with a family to support, they're not going to listen. You're going to lose. It's probably going to cost you

> penalties. It might cost you punitive damages. It's also going to cost about $50,000 to try the damn thing." If I say that to them, I have never in my life seen an instance where they pursued the legal [claim].

Rostain (2008, 474) recounted how one general counsel handled managerial conduct that was legal but risked tarnishing the company's image:

> He described a recent incident where employees had been interested in trading in company stock. Although he and other managers were confident that the trading was not suspect, he believed that from outside the company the conduct might look like insider trading. On the recommendation of the GC, the CEO issued instructions to stop the trading.

For companies marketing products to consumers, reputational concerns dominated strictly legal ones. As Rostain (2008, 477) reported:

> According to this GC [of a food processing company], he instructed [the lawyers] to ask themselves three questions, starting with whether the conduct was ethical. His test was whether he wanted it to appear in the *Wall Street Journal*—and then whether it was consistent with the company's core values. If action passed these two tests, then the last question was whether it was legal.

As evidenced above, inside counsel can sometimes draw on their knowledge of the company's "core values"—its corporate culture—to influence business decisions. Because inside counsel interface with different constituents and handle many aspects of the company's operations, inside counsel may better grasp the company's culture and acceptable risk levels. And because corporate law departments are often responsible for housing important corporate documents, inside counsel sometimes function as de facto company historians. Inside counsel can draw on this background in articulating the corporate culture to business managers and, as a result, exert persuasive influence (Rosen 2010, 130).

In sum, the empirical literature confirms behavior in accordance with the Model Rules. Inside counsel ultimately defer to businesspersons' authority on Quadrant I and II matters—where the proposed course of action is not unlawful but may generate some business risks. However, the findings also show that a significant number of inside counsel—whether they be classified as Entrepreneurs or Counsel—participate actively in such business decisions, acting more like participants with a vested interest in the outcome rather than mere advisers. More specifically, Entrepreneurs emulate their business colleagues. Indeed, many inside counsel consider the opportunity to participate in business decisions to be one of the chief advantages of working in-house

(Weaver 1997). By contrast, Counsel appear to be motivated by ethical concerns and long-term reputational consequences. As such, they act as a more corporate version of the lawyer-statesman (Kronman 1993), navigating a broad terrain that extends beyond questions of mere legality.

Quadrant III: Empirical Confirmation

Recall what the Model Rules say about Quadrant III matters (unlawful action; immaterial risk of harm). Although lawyers are free to give advice against taking unlawful action that poses little risk of harm, they must, in the end, defer to the manager's decision even if it is to ignore the lawyer's advice. (To be clear, the lawyer may not knowingly assist criminal or fraudulent conduct (Model Rule 1.2(d))). The Rules do not require lawyers to report up the corporate ladder when the risk of harm is immaterial. Comment 3 to Rule 1.13 specifically suggests a general duty of deference: "When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful." Do inside counsel act consistently with this prescription? Here, we run into some methodological complications within the empirical research. Because most studies failed to distinguish systematically between immaterial and material legal risks, it was frequently unclear whether inside counsel were reporting about Quadrant III or Quadrant IV matters. That said, to the extent that the matter clearly fell in Quadrant III, the empirical research seems to confirm that inside lawyers behave in accordance with the Model Rules' guidance.

Rostain (2008, 475) reported that an important function for general counsel was line drawing—"distinguishing more significant legal risks, which fell within their decisional purview, and less important legal risks that they left to managers to decide." This suggests that general counsel typically defer on Quadrant III matters but do not defer on Quadrant IV matters. For example, in one situation, a manager urged the company to save on significant compliance costs by ignoring the state advertising laws, which the company's competitors were ignoring. The general counsel noted that in such circumstances "he might leave it to the manager to decide" (476).

Another general counsel of a computer parts wholesaler stressed the importance of inside lawyers acting as team players for all but the most serious of legal risks:

> Our mission here as a legal team is to provide practical solutions to the highest priority problems in the business, so we view ourselves as having to provide solutions. Now, that doesn't mean that we're absolutely "yes men" and

> that they can do anything. Because we're not a highly regulated industry, there are very few things that we wind up doing that are going to be serious violations of a criminal or legal stature. If that's not the case, then all we're trying to do is help the team negotiate a business deal. (475)

Of course, as with all the quadrants, what falls in Quadrant III will not always be crystal clear. For example, the legality of a proposed course of action may be ambiguous. Perhaps the relevant facts are unique or uncertain and do not fit neatly within existing legal precedent. Or perhaps the facts are clear but the law is clumsily worded and subject to multiple interpretations. In such cases, absent overriding reputational concerns, inside counsel are likely to treat the matter as a business decision. As one general counsel explained:

> If the law is less than clear, or if the fact pattern isn't clear, then it is a matter of risk assessment. And one of the things that—and I am a firm believer—if it is a matter of assessing the risk, the lawyer's job is to give the best description or explanation of the risk and how it might impact the company and then ultimately it is a business decision. (Rostain 2008, 477)

In sum, for Quadrant III matters, the self-reported behavior of inside counsel generally conforms to the ethical floor of the Model Rules. Inside counsel cede to managers the right to determine ultimately Quadrant III matters—actions that may run afoul of some minor rule or regulation but are immaterial in terms of the risk of harm to the corporate entity. The lawyer may offer advice, but the manager makes the final call.

Quadrant IV: Empirical Uncertainty

Given the stakes, we would expect inside counsel to act most aggressively in Quadrant IV (unlawful action; material risk of harm). In addition, the Model Rules grant counsel the authority to escalate matters up the corporate ladder or even outside the organization, effectively vesting counsel with a powerful "trump." How do inside counsel approach Quadrant IV matters? Do they throw their weight around, even threatening to use their trump card? Or do they subordinate themselves to managers and leave it to them, again, to make the final call?

As mentioned above, since most researchers did not systematically distinguish the seriousness of legal risks, it was often unclear from respondents' remarks whether they were discussing Quadrant III or Quadrant IV matters. Moreover, it was unclear whether some of the respondents ever encountered a

Quadrant IV matter (Nelson and Nielson 2000, 471), which presumably occurs less frequently. Despite these complications, however, one can reasonably conclude from the studies that at least *some* inside counsel do escalate and assert their professional authority in Quadrant IV circumstances.

In particular, one breed of inside counsel, classified as "Cops" by Nelson and Nielsen, exhibited characteristics suggesting a willingness to interpose themselves in Quadrant IV matters. These Cops, comprising 17% of their respondents, identified most strongly with their status as lawyers and understood their primary job as policing the conduct of management. They performed an active gatekeeping role, "marked by an affirmative obligation to monitor compliance, the ability to say no to business clients, and the ability to go over the head of management" (2000, 468). Of all of Nelson and Nielsen's ideal types, Cops were most reluctant to tread outside of their expertise and offer nonlegal advice. They were also less likely than the others to soft-pedal their legal advice to minimize conflicts with the business folk. Perhaps for these reasons, there were significantly fewer Cops than Entrepreneurs in Nelson and Nielsen's study (487).

Similarly, the general counsel in Rostain's study "articulated a robust account of their jurisdiction over questions of legal risk" (2008, 473). They professed the willingness to say no in situations that appear to fall in Quadrant IV (i.e., situations implicating significant civil or criminal liability). Rostain (2008, 476) reported:

> With other legal risks, this GC was clear that his department's role was to say "no." [An example] came from the antitrust context: A manager who was quoted a competitor's price by a buyer wanted to contact the competitor to verify it. This lawyer was clear that in these situations, which were apparently not uncommon, he was firm that the conduct violated the law. As he put it, "When I make those statements that's pretty much [it]. People move on."

Another general counsel recounted how merely "issuing a threat (implicitly or explicitly) was sufficient to deter managers from such [risky] conduct" (474). According to him, typically, the manager would respond by loudly complaining "about the excesses of regulators or Congress," and then "the issue would then be dropped" (474). Yet another general counsel described how he occasionally displayed handcuffs in a board meeting to "get attention" (489).

Of course, not all inside counsel arrive at a board meeting, props in hand. Others just check in with the manager's boss, ultimately deferring the final decision to *a* business manager but policing the issue of who gets to decide. As one inside lawyer put it:

> Our job is to assess risks, and it's the business person's job to make decisions about risks, what risks they are willing to assume. Now, having said that, I also think of it as my job to make sure that the decision about what risks to assume is being made at the appropriate level. So, if somebody was prepared to assume a risk which I felt was inappropriate, I would say, "I don't think this is a decision for you to make. I need to talk to your boss." (Nelson and Nielson 2000, 473)

Escalating a matter to a manager's boss is not a decision made lightly. Like any corporate employee, inside counsel must be selective about which matters to take up to higher authorities. Otherwise, they run the risk of being tagged as "rigid" and being circumvented by "forum-shopping" managers who will turn to more pliable lawyers for advice (Nelson and Nielsen 2000; Gunz and Gunz 2008).

While inside counsel's power is constrained by pragmatic considerations, they still may exercise more influence than outside counsel. One inside lawyer, who formerly represented the company as its outside lawyer, remarked:

> I have to decide when legal issues should prevail. On the outside, I used to say, "Here is my opinion and the risks. It is up to you to decide whether you want to assume the risk." On the inside, it is the same principle, but if we put up enough of an argument against something, chances are it won't go through. You have to pick and choose when to do that. It requires some judgment about how strongly to say no. (Rosen 2010, 100)

This statement is consistent with anecdotes in other studies and, contrary to the conventional wisdom, suggests that inside counsel may be *more* likely than outside counsel to intervene in situations entailing serious legal risk.

Generally speaking, we see evidence that some inside counsel readily assert their professional authority when faced with serious legal risks. But should we infer that this is common behavior? As it turns out, the empirical literature seems deeply conflicted. According to Nelson and Nielsen, although, "when questioned, almost every attorney could imagine a situation in which he or she would go over the head of management to become a deal stopper" (2000, 471), only 17% of respondents (the Cops) exhibited strong gatekeeping proclivities. Indeed, the authors found that their respondents "typically leave the final call on acceptable levels of legal risk to the businesspersons involved" (2000, 486). Similarly, Rosen found that most inside lawyers were generally reluctant to challenge a manager's decision about legal risk (2010).

In contrast, Gunz and Gunz (2008) found that 59% of inside counsel's responses reflected some degree of willingness to challenge managerial decisions. Also, Gunz and Gunz found that a significant number of inside counsel, although never specifically quantified, reported being willing to "raise their heads above the parapet" (940), including resigning or reporting the matter to governmental authorities. Although difficult to know for sure (given that the authors reported the number of responses and not the number of inside counsel), it seems that Gunz and Gunz's inside counsel were (at least when responding to hypothetical questions) more willing to assert their authority to stop unlawful conduct than Rosen's or Nelson and Nielsen's lawyers.

Finally, Rostain provides the most robust account of inside counsel's willingness to interpose themselves in matters implicating legal risks. Contrary to Rosen's and Nelson and Nielsen's findings, Rostain's general counsel were not resigned to acting as mere advisers. Instead, her respondents "were unanimous in insisting that responsibility for determining the appropriate level of risk to be undertaken by their companies lay with them" (Rostain 2008, 473). They characterized their gatekeeping functions "in very strong terms" and were all "confident of their capacity to stop deals that they believed posed significant legal risks to the company" (Quadrant IV matters) (473–474). Although they occasionally found reason to cede the final call on low-level risks to managers (Quadrant III), these general counsel "were the ultimate arbiters of which risks were negotiable and which were not" (479).

How might these disparate empirical findings be reconciled? First, we should be cautious about what can be inferred from small samples. As Rostain readily acknowledged, hers was a pilot study of only 10 lawyers. Gunz and Gunz interviewed 25 inside counsel, Nelson and Nielsen drew on interviews with 42 lawyers (and 12 managers), and Rosen interviewed 77 people (including inside counsel, outside counsel, and business managers). Moreover, Rostain acknowledged the possibility of a biased sample (2008, 479): Most of her general counsel respondents "worked for traditional blue chip companies, none of which had a known history of legal problems or significant risk taking," and some described their companies as having a "deep culture of compliance" (474).

Second, the different findings may be explained by the type of respondents interviewed. Both Rosen and Nelson and Nielsen interviewed not only inside counsel but also their business colleagues. By contrast, Gunz and Gunz and Rostain confined their structured interviews to inside counsel. As a result, the latter studies, which are based solely on lawyers' self-reported behavior, may reflect a more self-serving account of inside counsel's power and willingness to police management. That said, Gunz and Gunz were the only researchers who employed vignettes, or "short cases describing hypothetical situations involving ethical dilemmas" (2002, 259), for their discussions with inside counsel. As they noted, "Vignettes have been described as particularly suitable for reducing social desirability bias, and indeed there is evidence that people are more likely to describe their real reaction to ethical dilemmas if presented with vignettes" (259).

Third, the various studies were conducted at different times and under different regulatory environments. The Rosen and Nelson and Nielsen studies were conducted prior to the enactment of Sarbanes-Oxley and the 2003 amendments to Model Rule 1.13. These events ushered in a period of enhanced criminal penalties and greater enforcement activity by regulatory agencies. By contrast, Gunz and Gunz and Rostain conducted their studies *after* Sarbanes-Oxley and the Model Rules amendments. (It is not clear whether or how Canadian counsel in the Gunz and Gunz study would be affected by these US events except indirectly.) Therefore, it is plausible that the findings of the latter studies (particularly Rostain's) reflected the enhanced power of general counsel as a consequence of an increased corporate commitment to compliance and risk management. While a majority of Rostain's general counsel insisted that their "gate-keeping role long predated the corporate scandals" (Rostain 2008, 479), most seemed to suggest that "the statute has had a subtle and wide spread influence on directors' approach to serving on boards and serves as resource for general counsel to draw on to assert their authority within the corporation" (489).

Fourth, the researchers interviewed lawyers with very different levels of seniority, which may have affected their willingness to assert their gatekeeping authority. Almost all of the lawyers in the Gunz and Gunz study were relatively senior in rank, with an average tenure of 22 years. Rostain's study was similarly confined to the most senior inside lawyers—general counsel. By contrast, Nelson and Nielsen culled from a wider pool of lawyers. In their sample, 10 of 11 (or 91%) of the respondents working in corporate or divisional management indicated that they made the final decision about whether to incur a legal risk. But only 35% of other (more junior) lawyers claimed to make that final call. As one general counsel in the Gunz and Gunz study explained, "Just sort of letting senior management handle it, that may work fine for more junior lawyers in a legal department and in fact that it may be asking too much of them to do anything more than that. But general counsel can't stop here" (2008, 936). This explanation is also consistent with theories of "ethical learning," whereby "lawyers gradually acquire specialized ethical expertise" (Chambliss, chapter 3, 000; Chambliss and Wilkins 2002).

Seniority may also play an indirect role in the fifth explanation, which focuses on how legal matters are distributed among various lawyers within a single legal department as determined by the particular lawyer's seniority level. Since different types of matters may be routinely handled by different lawyers, respondents may have been approaching the same key question ("Who makes the final call on acceptable levels of legal risk?") from very different vantage points. Since, for many companies, the general counsel cannot personally evaluate every single legal risk facing the company, the legal risks that are likely to percolate to the general counsel are precisely those that pose the gravest threat to the company. And those legal risks are likely to be the ones that come to mind when general counsel report in surveys whether they had the right to make the final call. If true, it should not be surprising that Rostain's general counsel—the highest-ranking lawyers in their respective companies—insisted that they had the final authority to decide whether to assume a particular legal risk. For the same reason, it should not be surprising that only half of Nelson and Nielsen's inside counsel, which included both senior and less experienced lawyers, said they made the final call on legal risks.

The fifth explanation is consistent with Gunz and Gunz's observation that the closer the lawyers were to "the top management team . . . the more often they encountered ethical dilemmas" (2008, 930). This explanation is also consistent with anecdotal evidence suggesting a division of labor between senior inside counsel and subordinate inside counsel based roughly on the seriousness of the legal risks posed. For example, John Donnell (1970) found that one general counsel handled antitrust matters (which could implicate criminal liability) while his subordinate inside counsel handled more routine contracts matters (which normally pose, at most, contractual liability). Accordingly, it may be that when answering survey questions, the more senior lawyers were considering a pool of matters with higher concentrations of Quadrant IV risks than the pool of matters considered by the more junior lawyers.

In sum, it seems clear that some inside counsel do assert their gatekeeping authority for matters potentially falling in Quadrant IV. Where the empirical literature is inconclusive is the extent to which inside counsel make the final call on legal risks. Further research that more carefully distinguishes between Quadrant III and Quadrant IV legal risks and accounts for seniority status would illuminate how robustly inside counsel exercise their gatekeeping authority.

Conclusion

Inside counsel's role demands the complex balancing of colliding norms and competing interests. Lawyers working in-house feel considerable pressure to accede to management's demands and to search for creative legal means of achieving business objectives. Instead of hindering business by throwing up roadblocks, inside counsel are pressured to "Be the Solution," as the conference title of the Association of Corporate Counsel's 2010 annual meeting exhorts. The discretion of inside counsel is thus constrained by business ends.

At the same time, inside counsel must also play a gatekeeping role and protect the company from more serious legal risks. The empirical research is still inconclusive as to what extent inside counsel assert their authority to make the final call on acceptable levels of legal risks. Generalizations are difficult because of the tremendous complexity and variability in approaches both across different contexts and among the various inside lawyers. As the researchers acknowledged, efforts to classify lawyers according to their most typical counseling approach may obscure important variations in their individual approaches to different problems. Nelson and Nielsen observed that "inside counsel play different roles in different circumstances" and that the interviews "are full of seemingly contradictory statements, until one realizes that the lawyers are describing a repertoire of responses to different situations" (2000, 463). Hence, they wisely caution against a reductionist interpretation of inside counsel's identities and strategies.

Building and expanding on the analytical framework developed in this chapter, the next generation of research on inside counsel should concentrate on isolating the sources of these observed variations, such as the nature of the risk (e.g., business, legal, public relations, material, immaterial); companies' risk tolerance levels/risk culture; the individual characteristics of inside counsel (e.g., personality, seniority, or tenure at the firm); the organizational structure and size of the corporate law department; the nature of the industry and the competitive position of the firm within the industry; and the extent to which globalization has changed inside counsel's practices. Inside counsel are crucially important intermediaries between law and economic power. We need to gain a better understanding of their behavior.

References

Abel, Richard L. 1989. *American Lawyers*. New York: Oxford University Press.

Beardslee, Michele DeStefano. 2009. "Advocacy in the Court of Public Opinion, Installment One: Broadening the Role of Corporate Attorneys." *Georgetown Journal of Legal Ethics* 22:1259–1333.

Beardslee, Michele DeStefano, John C. Coates IV, Ashish Nanda, and David B. Wilkins. 2010. "Hiring Teams from Rivals: Theory and Evidence on the Evolving Relationships in the Corporate Legal Market." http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1442066.

Brown, Louis M. 1950. *Preventive Law.* New York: Prentice-Hall.

Carson, Clara N. 2004. *The Lawyer Statistical Report: The U.S. Legal Profession in 2000.* Chicago: American Bar Foundation.

Chambliss, Elizabeth, and David B. Wilkins. 2002. "The Emerging Role of Ethics Advisors, General Counsel, and Other Compliance Specialists in Large Law Firms." *Arizona Law Review* 44:559–592.

DeMott, Deborah A. 2005. "The Discrete Roles of General Counsel." *Fordham Law Review* 74:955–981.

Donnell, John D. 1970. *The Corporate Counsel: A Role Study*. Bloomington: Indiana University Press.

Gruner, Richard S. 1997. "General Counsel in an Era of Compliance Programs and Corporate Self-Policing." *Emory Law Journal* 46:1113–1196.

Gunz, Hugh P., and Sally P. Gunz. 2002. "The Lawyer's Response to Organizational Professional Conflict: An Empirical Study of the Ethical Decision Making of In-House Counsel." *American Business Law Journal* 39:241–287.

———. 2008. "Ethical Decision Making and the Employed Lawyer." *Journal of Business Ethics* 81:927–944.

Hackett, Susan. 2002. "Inside Out: An Examination of Demographic Trends in the In-House Profession." *Arizona Law Review* 44:609–619.

Hazard, Geoffrey C., Jr. 1997. "Ethical Dilemmas of Corporate Counsel." *Emory Law Journal* 46:1011–1022.

Hazard, Geoffrey C., Jr., and W. William Hodes. 2005. *The Law of Lawyering.* 3rd ed., vol. 1. New York: Aspen.

Kim, Sung Hui. 2005. "The Banality of Fraud: Re-Situating the Inside Counsel as Gatekeeper." *Fordham Law Review* 74:983–1077.

———. 2008. "Gatekeepers Inside Out." *Georgetown Journal of Legal Ethics* 21:411–463.

Kronman, Anthony. 1993. *The Lost Lawyer: Failing Ideals of the Legal Profession*. Cambridge, MA: Harvard University Press.

Liggio, Carl D. 1997. "The Changing Role of Corporate Counsel." *Emory Law Journal* 46:1201–1222.

Nelson, Robert, and Laura Beth Nielsen. 2000. "Cops, Counsel, and Entrepreneurs: Constructing the Role of Inside Counsel in Large Corporations." *Law & Society Review* 34:457–494.

Painter, Richard W. 1994. "The Moral Interdependence of Corporate Lawyers and Their Clients." *Southern California Law Review* 67:507–584.

Postema, Gerald J. 1980. "Moral Responsibility in Professional Ethics." *New York University Law Review* 55:63–89.

Rosen, Robert Eli. 2010. *Lawyers in Corporate Decision-Making*. New Orleans: Quid Pro.

Rostain, Tanina. 2008. "General Counsel in the Age of Compliance: Preliminary Findings and New Research Questions." *Georgetown Journal of Legal Ethics* 21:465–490.

Schwartz, Murray L. 1978. "The Professionalism and Accountability of Lawyers." *California Law Review* 66:669–697.

Simon, William H. 1978. "The Ideology of Advocacy: Procedural Justice and Professional Ethics." *Wisconsin Law Review* 1978:29–144.

Spangler, Eve. 1986. "Company Men Through and Through: Corporate Staff Counsel." In *Lawyers for Hire: Salaried Professionals at Work*, 70–106. New Haven, CT: Yale University Press.

Sterngold, James. 2010. "Who Cares About Another $200 Million?" *Bloomberg Businessweek*, May 3–May 9, 56–59.

Weaver, Sally R. 1997. "Ethical Dilemmas of Corporate Counsel: A Structural and Contextual Analysis." *Emory Law Journal* 46:1023–1051.

Cases, Statutes, and Regulations

Balla v. Gambro, Inc., 584 N.E.2d 104 (Ill. 1991).

Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, 784.

17 C.F.R. §§ 205.1–205.7 (2010).