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PERSPECTIVES

ETHICAL DILEMMAS OF CORPORATE COUNSEL

*Geoffrey C. Hazard, Jr.**

INTRODUCTION

In my opinion, the role of corporate counsel is among the most complex and difficult of those functions performed by lawyers. This is not to overlook the difficulties entailed in the role of the advocate, particularly in criminal cases, of the family counselor, for example, in estate planning for spouses in a second marriage, or of the lawyer for a small business, particularly a business that has passed into a second or third generation of family ownership. Nevertheless, the role of corporate counsel entails intrinsic ambiguities that must be worked through in the ordinary course of a day's work with far greater frequency than in most other practice settings.

My discussion refers specifically to the role of lawyers who are in full time employment by their client, as distinct from lawyers with independent law firms who are designated general counsel. I also shall focus on lawyers on the staff of private business clients, as distinct from the legal staff of government, although government lawyers often encounter ethical problems similar to those that arise for their private counterparts. In general, I have in mind practitioners who are members of a multi-lawyer legal staff, as distinct from one-person law departments.

Lawyers coming within this description have gained full recognition in the last two or three decades or so. In an earlier day, the term "house counsel" was one of double disparagement. The term implied a lawyer who labored under a client's thumb, unable to exercise the "independent professional judgment" that was a defining characteristic of "real" lawyers. The term also implied a practitioner who lacked some of the qualifications necessary to

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practice law and thus sought refuge in employment in a corporate law department. That second-class citizenship has ceased now largely as a result of various long term social forces. Among these forces are:

- The need of corporate enterprise for continuous legal assistance, readily at hand and already familiar with the corporation's operations and legal environment;
- The increasing specialization of all lawyers, whereby employment by a single client becomes simply another form of specialization;
- The growth of the large law firm, where the working environment for the average lawyer is not much different from, and often is worse than, that in corporate law departments;
- The strategic position of inside corporate counsel in determining whether to employ outside counsel and which law firms are to get the prizes;
- The affirmative self-assurance of corporate counsel, manifested in their own organizations, publications and special identity.

As a consequence of these developments, the role of corporate counsel has become clearly established, both functionally and ethically. But the clarity of the role does not necessarily imply clarity in ethical responsibilities. On the other hand, an aspect of the special identity of corporate counsel is the special character of the ethical dilemmas that they face. I propose to address these dilemmas in terms of three interrelated dimensions. These are as follows:

- Who is the client?
- How does a corporate lawyer deal with the duty to get "all" the facts?
- What are the responsibilities among lawyers having different hierarchical positions within a law department?

In addressing these questions, I shall proceed within the framework of the law governing lawyer responsibility as set forth in the Model Rules of Professional Responsibility promulgated by the American Bar Association (ABA) in 1983 and in the new Restatement of the Law Governing Lawyers.¹ I believe that these rules essentially correspond to the law governing lawyers as it has come down to us through the common law and the earlier ABA Code of Professional Responsibility. But the special virtue of the Rules of Professional Conduct and the Restatement is to make explicit what previously had been only implied or stated in the fragmentary form of decisional law. I regard

¹ See RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS (Proposed Final Draft No. 1, 1996).

these formulations not as fraternal admonitions but as legal rules which deserve respect.

As I shall try to suggest in addressing these issues, the order in which they are stated seems to me to have a necessary logic. The issues are: Who is the client? What are the responsibilities of lawyers to clients in this context? And what are the responsibilities among lawyers in a corporate law department when difficult ethical issues arise?

I. WHO IS THE CLIENT?

Rule 1.13(a) clearly states the basic proposition that "[a] lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents."² This proposition is affirmative and, by implication, negative as well. Affirmatively, it states that the client is the organization, a term that includes corporations, partnerships and unincorporated associations. Negatively, the proposition is that the corporate lawyer does not represent the "constituents" of the organization, who include the officers, directors, employees and stockholders. Of course, a lawyer for a corporation may concurrently represent one or more of these constituents. However, when such a concurrent representation is undertaken, or found in retrospect to have existed, the lawyer then has two clients—the organization and the corporate officer, employee or other constituent. Having two clients immediately implicates the problem of conflict of interest.³

The legal position of the corporate officers, directors and employees in relation to the corporate client is that of an agent. This relationship is addressed in Rule 1.13(a) by the phrase "acting through [the organization's] duly authorized constituents." The term "duly authorized constituents" immediately poses two related problems. First, representation of a client that is a corporation or other organization requires the lawyer to deal firsthand with a person who is not his client but rather the agent of his client. Put starkly, a lawyer for a corporation never deals with the client as such but only with what I call "client-people," the corporate managers who undertake to speak for the client. Second, and relatedly, is the problem of whether the "client-person" has authority in the matter in which he or she purports to speak for

² MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(a) (1982).

³ See, e.g., *E.F. Hutton & Co. v. Brown*, 305 F. Supp. 371 (S.D. Tex. 1969).

the corporation. By way of illustration of this problem, consider the dilemma in ancient times faced by a shore merchant dealing with a ship's crew, and think of the ship as a corporation: Does the captain of the ship have authority from the owners to commission expensive reequipping or repair of the vessel? Put more colloquially, the problem for an attorney dealing with a corporate official is: "Who is this guy anyway?"

In the practice of corporate law, this question ordinarily does not arise. Instead, the officers and employees of the corporation have their defined roles in the company. Those roles entail authority and responsibility to decide, give direction, and act on behalf of the corporate client. Moreover, the corporate official's job description ordinarily implies a clear distinction between the business aspects of a problem and its legal aspects. The company official evaluates the business aspect, and the lawyer gives counsel, advice or technical assistance on the legal aspects. The decisive judgment calls, even when they entail substantial financial, political or legal risk, are for the corporate officials, not for the corporate lawyer. But there is a limit to the corporate official's authority. The corporate official cannot lawfully overstep the limits imposed by the principles of agency law on an agent's authority to commit to a course of action on behalf of the principal.

These limits are recognized in Rule 1.13(b) of the Model Rules.⁴ That long

⁴ Rule 1.13(b) provides:

If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the lawyer shall proceed as is reasonably necessary in the best interest of the organization. In determining how to proceed, the lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters and any other relevant considerations. Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. Such measures may include among others:

- (1) asking reconsideration of the matter;
- (2) advising that a separate legal opinion in the matter be sought for presentation to appropriate authority in the organization; and
- (3) referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b) (1982).

paragraph is not a direction to the corporate lawyer one way or the other, as indeed it could not be. Rather, it is a protocol or pathway of thought that the corporate lawyer should employ when confronted with a corporate official's or employee's problematic exercise of purported authority. The triggering event in Rule 1.13(b) is conduct or inaction by the corporate "client-person" that involves a "violation of legal obligation to the organization" or a "violation of law which reasonably might be imputed to the organization."⁵ This definition substantially corresponds to the business judgment rule which generally protects corporate employees.⁶ In terms of corporate management, the concept equates to what might be called a "damn fool and dangerous idea."

Rule 1.13(b) requires the corporate lawyer, confronted with the agency problem just described, to proceed in the "best interests" of the corporation. The available courses of action include asking the corporate official to reconsider his decision; seeking another opinion, inside or outside the law department; and going "up the corporate ladder." Rule 1.13(c) provides that the lawyer may have to go all the way to the board of directors or, in the end, resign.⁷ Needless to say, there is danger to the lawyer attending every step beyond asking the corporate official to reconsider—and sometimes danger even there.

I do not wish to dwell on the difficulties for corporate counsel resulting from this responsibility to the corporate client when counsel is in serious disagreement with top management. These difficulties are all too familiar. The ultimate risk is not only being fired, with loss of employment, fringe benefits and pension rights, but the possibility of being professionally black-listed. Unfortunately, there are officials in corporate management who do not care about complying with the law or who feel that they cannot afford to do so.⁸ Many of them will not hesitate in firing a lawyer who gives them a hard

⁵ *Id.*

⁶ See AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 (1994). See also *id.* § 4.02 (reliance by directors and officers on expert advice, including that from legal counsel).

⁷ The exact words of Rule 1.13(c) are:

If despite the lawyer's efforts in accordance with paragraph (b), the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly a violation of the law and is likely to result in substantial injury to the organization, the lawyer may resign in accordance with Rule 1.16.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 113(c) (1982).

⁸ Compare *Balla v. Gambro, Inc.*, 584 N.E.2d 104, 108 (Ill. 1991) (stating that "generally, in-house

time and then bad-mouthing the lawyer afterward. No system of rules can eliminate that risk. Rather, I want to focus on the problems confronted by corporate counsel which can lead into this dangerous situation. This leads to the second of my basic questions.

II. HOW DOES A CORPORATE LAWYER DEAL WITH THE SUPPOSED DUTY TO GET "ALL" THE FACTS?

The duty to inquire into facts is subsumed under the general requirement of diligence in representation of the client. As stated in Model Rule 1.3, "[a] lawyer shall act with reasonable diligence . . . in representing a client."⁹ This duty also has its roots in common law principles of agency law. Every lawyer and every client presume that the duty of diligent service exists and will be fulfilled.

The duty of diligence often is described as requiring the lawyer to know "all" the facts. Such a recitation appears in the ABA Standards of Criminal Justice as an aspect of the duty of a criminal defense lawyer.¹⁰ However, lawyers who actually practice criminal defense law have a much more subtle understanding of this obligation.¹¹ The obligation, as they understand it, is to find out what is needed to do the job. Doing their job requires that criminal defense lawyers *not* inquire into what the client has done if that inquiry will complicate the defense of the case.¹²

In my observation, this cautious approach is equally necessary in representation of clients in civil matters—in transactions as well as in litigation. The importance of knowing the facts, especially when doing "due diligence" in a transaction, should not be minimized. Where the lawyer's undertaking is to

counsel do not have a claim under the tort of retaliatory discharge"), *with Nordling v. Northern States Power Co.*, 478 N.W.2d 498, 499 (Minn. 1991) (deciding that the attorney-client privilege does not preclude in-house counsel from bringing a claim for wrongful discharge), and *General Dynamics Corp. v. Superior Court*, 876 P.2d 487 (Cal. 1994) (also permitting in-house counsel to bring a wrongful discharge claim against his corporate employer). See also Sara A. Corello, Note, *In-House Counsel's Right to Sue for Retaliatory Discharge*, 92 COLUM. L. REV. 389 (1992). Cf. *Wieder v. Skala*, 609 N.E.2d 105, 108 (N.Y. 1992) (rules of professional ethics are an implied term of a lawyer's employment agreement).

⁹ MODEL RULES OF PROFESSIONAL CONDUCT Rule 13 (1982).

¹⁰ See AMERICAN BAR ASSOCIATION, STANDARDS FOR CRIMINAL JUSTICE, § 4-4.1 (1992).

¹¹ See K. MANN, DEFENDING WHITE-COLLAR CRIME: A PORTRAIT OF ATTORNEYS AT WORK 103-23 (1985).

¹² For a vivid example of the consequences of disregarding this wisdom, see *Nix v. Whiteside*, 475 U.S. 157 (1986).

verify affirmations about the client's financial or operational condition, the lawyer must get all of the facts. However, other situations may arise in which the client will be better off if the lawyer does not know everything there is to know about the corporate situation.

Certainly, a corporate lawyer can be better off in this respect. What is a junior law department lawyer to do, for example, if she concludes that the chief executive officer (CEO) is using the company plane for trips to Acapulco with a very close friend? Or that discussions at trade conventions involving the son of the chairman of the board can be construed as price-fixing? Or that the underground petroleum tanks are still leaking? The client also may be better off if the actual possibility is small that the legal wrong will be detected by others, especially by law enforcement authorities or civil liability antagonists.

In practice, it is not unusual for the lawyer in a corporation's law department to encounter clues suggesting such ominous implications. An even more common experience, I am told, is for law department lawyers to encounter various kinds of legal corner-cutting within the corporation. Though most of the corner-cutting is not very serious, some definitely is.

How wide open should a corporate counsel's eyes be kept? What signs of legal impropriety should be further investigated? Who should be consulted inside the law department or outside of it?

These questions, like all important ethical questions, cannot be answered categorically. Sometimes one's eyes must be kept wide open and signs pursued to definitive resolution. One would like to hope that every corporate law department follows this standard. I am sure that not every department is so diligent, however. Corporate lawyers cannot be distinctly more virtuous than the corporate management by which they are employed, and many corporate managements are not distinctly virtuous. Hence, sometimes a corporate lawyer will fail, more or less consciously, to see what is there to be seen.

Lawyers in a corporate law department, as they are often reminded, are part of the "corporate team." This slogan is a claim of primary loyalty by the corporate client. Yet, it is no stronger a claim than clients implicitly make upon lawyers in independent practice. After all, the independent lawyer's client also can say, "What am I paying you for?"

In terms of the Rules of Professional Conduct, corporate lawyers, like their counterparts in independent practice, can accommodate their obligations to

the client and to the legal system. Hence, there is no formal difference in the intersection of obligations to the client and obligations to the legal system that are imposed on the corporate lawyer and those governing the lawyer in independent practice. The boundaries of these obligations are mandated by the requirement that a lawyer not counsel or assist a client in criminal or fraudulent conduct, as stated in Rule 1.2(d),¹³ and by the duty under agency law to protect the corporate client from legal wrongs by its employees.

However, there is a considerable difference in the work situation in which the corporate lawyer must respond to these obligations and the work situation of the lawyer in independent practice. The difference can be summarized by reference to the company water cooler. I use the term "water cooler" in a metaphorical sense. It refers to the places and occasions for informal information interchange that occur in all employment settings: the company cafeteria, the car pool, the informal exchanges preceding company committee meetings, the evening get-togethers during out-of-town trips, and even the company picnics. These are opportunities for exchange of back-channel information, office gossip, rumors and portents of future corporate undertakings that have not yet been announced officially.

I recall an observation by a high-ranking executive of a leading company to a university official concerning the significance of office rumors. In this case, the rumors were about a decision made by a university department. The university official protested that one could not operate a university paying attention to rumors. The executive responded that he could not run his company without paying attention to rumors.

Back-channel information often either is accurate or leads to accurate information. The corporate lawyer necessarily is exposed to this sort of information all the time. What is to be made, for example, of the company pilot's remark about the nice beaches in Acapulco or the discovery of old records showing when the underground tanks were acquired?

¹³ Rule 1.2(d) states:

A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.2(d) (1982).

Here lies the most significant difference between corporate counsel and lawyers in independent practice. The difference, simply stated, is in the factual conditions of their day-to-day work. To put the point bluntly, a lawyer in independent practice is sheltered from the informal, back-channel information that flows around the company water cooler. Instead, engagement of an independent law firm is necessarily predicated on a distillation of the facts about the matter in question. This is so even when the outside lawyer is given all of the documents and access to all of the company employees. Back-channel information simply cannot be recreated. And there are times, I have been told, when outside counsel may be retained on the basis of selected facts precisely to accommodate a response that provides a desired outside opinion. We can harken to Rule 1.13(b)(3), where one of the options is to obtain "a separate legal opinion on the matter" to be presented" to appropriate authority in the organization."¹⁴

The lawyers inside the company law department are not so sheltered. In this respect, paradoxically, lawyers in a corporate law department confront situations that resemble the ethical challenges faced by the criminal defense lawyer. In all kinds of law practice, there are times when the lawyer should not know everything, even though lawyers in independent practice are extremely reluctant to acknowledge that truth. This brings us to the third problem I introduce.

III. WHAT ARE THE RESPONSIBILITIES AMONG THE LAWYERS HAVING DIFFERENT HIERARCHICAL POSITIONS WITHIN A CORPORATE LAW DEPARTMENT?

As a matter of the law governing lawyers, every lawyer is an autonomous professional. As such, every lawyer is personally bound in full measure by obligations imposed on members of the profession—the Rules of Professional Conduct and the common law rules governing lawyers. As a matter of the law of corporations, however, every employee is stationed in a hierarchy of authority descending from the board of directors, through the CEO, to department directors, and so on. A member of a corporate law department is stationed in a similar hierarchial structure. These concepts are inevitably, if not obviously, in contradiction. The same contradiction arises in law firms: whose call is it in a law firm when a tough ethical problem is presented—that of the

¹⁴ MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.13(b)(2) (1982).

junior lawyer who recognizes the problem or the senior lawyer who acts for the firm?

The Rules of Professional Conduct address this contradiction between organizational hierarchy and professional autonomy. In addressing this problem, the Rules, in principle, broke new ground. The earlier lawyer codes were based on the premise that lawyers were all solo practitioners.

Rule 5.1(b) speaks to law departments, private and public. It states that "[a] lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct."¹⁵ Rule 5.1(c) follows through by stating that "[a] lawyer shall be responsible for another lawyer's violation of the rules of Professional Conduct if (2) the lawyer . . . has direct supervisory authority over the other lawyer, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action."¹⁶

These rules impose on a lawyer with supervisory authority a direct personal responsibility, under the specified conditions, for ethical compliance by lawyers over whom the supervisor has authority. The same concept in corporation law defines the responsibility of upper-level management within the corporation. At the same time, Rule 5.2 states:

"(a) A lawyer is bound by the Rules of Professional Conduct notwithstanding that the lawyer acted at the direction of another person. (b) A subordinate lawyer does not violate the Rules of Professional Conduct if the lawyer acts in accordance with a supervisory lawyer's reasonable resolution of an arguable question of professional duty."¹⁷

Paragraph (a) of Rule 5.2 affirms the professional autonomy of lawyers.¹⁸ It requires a subordinate lawyer to fulfill his duties as a lawyer, even in the case of a contrary instruction by a supervisor. The term "another person" applies equally when the other person is a lawyer having superior managerial authority as when the other person is a client.

¹⁵ MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.1(b) (1982).

¹⁶ MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.1(c) (1982).

¹⁷ MODEL RULES OF PROFESSIONAL CONDUCT Rule 5.2 (1982).

¹⁸ *Id.*

Paragraph (b) of Rule 5.2 provides a narrow safe harbor for junior lawyers.¹⁹ It allows a junior lawyer to justify action or inaction on the basis of a superior's orders. But justification arises only when the superior's order constitutes a "reasonable resolution" of the ethical issue at hand.

In parsing Rules 5.1 and 5.2, members of a corporate legal staff will recognize tension between these provisions. In some applications, there will be a contradiction in the practical implications of these two rules. The contradiction does not arise from the language of the rules. After all, if the superior's resolution of the problem indeed were "reasonable," there would be no ethical violation by either the superior or the subordinate. Rather, the tension will arise if the superior lawyer and the subordinate have different reconstructions of the facts. The typical problem is where the facts appear to the young lawyer to require some kind of interdiction or "whistle-blowing" on the part of the legal staff, whereas no such action is required according to the facts as the superior perceives them.

There is no way that legal rules can avoid the possibility of contradictory interpretations of facts. The nub of the ethical problem is that, upon one interpretation of the facts, there is a duty to go "up the corporate ladder;" whereas upon the other interpretation, there is no such necessity. Needless to say, a serious discrepancy in interpretation in this respect can destroy, or at least do serious injury to a corporate law department.

However, a properly run law department should have little risk of such a conflict. This brings us to the issue of ultimate responsibility for the integrity of a corporate law department. Make no mistake that the responsibility rests with the general counsel.

CONCLUSION

In a properly run law department, the general counsel is alert to back-channel information as well as to "official information" within the corporation. The general counsel knows that early interception of legally improper conduct is much easier than cleaning up a mess after the fact. The general counsel has made it clear, by deed as well as pronouncement, that his or her door is open for confidential discussion with any lawyer down the line who confronts an

¹⁹ Perhaps paragraph (b) could more aptly be described as a cove rather than a harbor.

ethically troublesome situation. The general counsel has also made it clear, by deed as well as pronouncement, that he or she will take to the CEO, or to the Board of Directors if necessary, any matter requiring such a reference. The general counsel must further make clear in the same way that, assuming the staff lawyers have been able to refer difficult problems to the head legal office, the incumbent in the office will take responsibility for resolving them. The general counsel knows that being open but tough-minded about ethical problems is much more effective than being sanctimonious.