

Ethics Immersion for In-House Counsel - 2011: A "Top Ten" Tour of the Issues

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*ACC's New-to-In-House Seminar
Corporate Counsel University - CCU*

Top Ten Ethics Issues for In-House Counsel

1. Licensing, MJP and Lawyer Mobility
2. "Who's the Client?"
The interests of management vs. the interests of the entity
The interests of the employee you "advise" vs. the entity
Business versus Legal
3. Conflicts of Interest – Internal to Your Company
When your employer includes multiple entities
Conflicts in mobility: losing/hiring new in-house staff
4. Conflicts and Waivers – Outside Counsel

Top Ten Topics ... (Cont.)

5. Supervisory responsibilities – are you paying attention?
6. Suing your employer-client/retaliatory discharge
7. Confidentiality and privilege under stress
8. Privilege, Confidentiality and Financial Transparency: audits and financial disclosures
9. Gatekeeping/Emerging theories of IHC liability
10. Navigating ethical issues in the changing client service paradigm

Overview:

Ethics and Professional Regulation

- The rules were created with outside practice (circa 1895) in mind
- Representing a single client entity poses challenges that the rules don't address, and many courts and regulatory authorities don't understand in-house practice
- From the date of your admission to the moment you realize that you're practicing "business decision-making," and not just law, in-house counseling presents challenges.
- A small comfort: in-house counsel are empirically least likely to be brought up on disciplinary charges (we'll get to the bad news -- the *increasing* likelihood you'll be scrutinized in a criminal context -- later in our discussion).

Gatekeeping challenges in the Post-Enron prosecutorial environment:

- Post-Enron, public opinion of companies has never been lower ... and expectations are higher and scrutiny stronger.
- Has the role of lawyers actually changed post-Enron, or has the scrutiny applied to their actions (or inactions) simply increased or changed focus?
- A "sea change" for legal ethics: Professional responsibility has always been concerned with the lawyer's behavior, but is increasingly focused on the lawyer's responsibility for the client's behavior.
- The "gut test" is a dangerous strategy.

Let's get started

.... At the beginning!

ACC's Top Ten Ethics Issues for Corporate Counsel

Number One: MJP – Multijurisdictional Practice

MJP and Admissions/Licensing Basics

- Admission in a “home” state upon passage of the bar and an ethics/character review ...
 - The profession is regulated by “geography”
 - Limits on the lawyer’s license to practice - Rule 5.5
- What do you know about the confines of your practice? What is it you’re competent to do?
- What is it that your client needs you to do?
- Is it different when you’re in-house?

Raise your hand if...

- You’ve ever traveled to a state in which you are not admitted and worked on a client matter or returned client phone calls?
- You’ve participated in pre-trial preparations or settlement discussions in another jurisdiction?
- You’ve retained outside counsel to represent you “nationally”?
- You’ve counseled clients located in a facility or anywhere outside of your “home” state?

Congratulations

.... You're engaged in MJP.

(Multijurisdictional Practice)

So what ... who's watching?



Birbrower brings it home:

- **The California Supreme Court** holds that a NY law firm can't collect its fees for work done in CA; MJP gains national attention.

Guerilla warfare tactics:

- The UPL rules used -- not for the protection of the public -- but as a "gotcha" tactic between opponents.

How does MJP "work" and where are the traps for the unwary?

Old and New Model Rule 5.5

Old Model Rule 5.5

A lawyer shall not practice law in a jurisdiction in violation of the regulation of the legal profession in that jurisdiction or assist another in doing so.

(The double whammy for in-house counsel)

New Model Rule 5.5

5.5(a) A lawyer shall not practice law in a jurisdiction in violation of the regulation of the legal profession in that jurisdiction or assist another in doing so.

5.5(b) A lawyer who is not admitted to practice in this jurisdiction shall not:
(1) except as authorized by these Rules or other law, establish an office or other systematic and continuous presence in this jurisdiction for the practice of law; or
(2) hold out to the public or otherwise represent that the lawyer is admitted to practice law in this jurisdiction.

5.5(c) [temporary incursions]

A lawyer admitted in another United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services on a temporary basis in this jurisdiction that:

- (1) are undertaken in association with a lawyer who is admitted to practice in this jurisdiction and who actively participates in the matter;
- (2) are in or reasonably related to a pending or potential proceeding before a tribunal in this or another jurisdiction, if the lawyer, or a person the lawyer is assisting, is authorized by law or order to appear in such proceeding or reasonably expects to be so authorized;

5.5(c) [temporary incursions, continued]

(3) are in or reasonably related to a pending or potential arbitration, mediation, or other alternate dispute resolution proceeding in this or another jurisdiction, if the services arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice and are not services for which the forum requires pro hac vice admission; or

(4) are not within paragraphs (2) or (3) and arise out of or are reasonably related to the lawyer's practice in a jurisdiction in which the lawyer is admitted to practice. *[the catch-all clause]*

5.5(d) [permanent practice - in-house counsel]

A lawyer admitted in another United States jurisdiction, and not disbarred or suspended from practice in any jurisdiction, may provide legal services in this jurisdiction that:

- (1) are provided to the lawyer's employer or its organizational affiliates and are not services for which the forum requires pro hac vice admission; or
- (2) are services that the lawyer is authorized by federal or other law to provide in this jurisdiction.



What is a temporary incursion under 5.5(c)?
What are its limitations?

- How long is temporary?
- Recurring / anticipated?
- What about incursions in other states that haven't passed these rules, or non-US incursions?
- Given technology, aren't we virtually everywhere all the time?

Is 5.5(d)(1) a 'complete' authority? IHC Registration Rules

State bars passing 5.5 often adopt an IHC registration rule even though it's not required by the rule.

State bars' discomfort with unregistered presence

"Model" registration rules... Which rules are better than others? ABA Model Rule.

Is "no rule" a good rule?



MJP basics to remember:



- 5.5(d) Authorization or registration for "permanent practice" by IHC
- Temporary incursion authorization in states that have passed 5.5 reforms (outside of court)
- *Pro hac vice* admission when necessary in court
- Foreign counsel rules: inadequate but evolving - 5.5 does not help non-US educated/licensed lawyers
- No good guidance on "virtual" counseling
- Watch for "guerilla warfare" tactics: gotcha!
- Remember supervisory responsibilities [5.1 & 5.5(a)]
- Avoid complacency: No one cares until they move.

What about boundaries beyond the 50 states?



The globalization of firm and IHC practice.

What to watch for:

- not just an issue of local admission, but whether IHC are recognized by the bar/ authorized to practice (e.g., Akzo)

Impact on client perceptions of IHC value
When giving cross-border advice, remember privilege and related concerns

GATS and other "treaty-level" discussions
ACC's IPA - a helpful resource

Which states have adopted rules?

- Depending on how you count them, about 3/4 of states have adopted “robust” MJP reforms
- Prospects for further reform and regulation?
 - Admission on motion in the US?
 - National admission standards or practical policies?
 - Regional or Cross-Border pacts?
 - International reciprocity/recognition?

Okay, so now you’ re properly authorized to practice

... just who the heck is your client, and how do you avoid replacing the client’ s judgment with your own?

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Number Two:
Who’ s the Client?

Who's the Client?



The "entity" is a fiction. The board does not run the daily operations of the company. Yet the entity, as represented by the board, is your client.

Management is made up of (fallible) folks you counsel all day, who think of you (and whom you've cultivated to think of you) as "their lawyer."

And then there are the other "stakeholders" who think you owe them a duty: employees, regulators, shareholders, third party partners, the "public" ...

Who's the Client?

Against that background (of many clients, who may or not be those you're obligated to represent at any given time):

How do you decide when any of those folks are acting within the best interests of the entity?

- What is appropriate risk (ERM)? Different companies have different appetites, and it doesn't make them criminals, does it?
- When should you exercise the "legal, but stupid" rule and assert your business judgment over the client's? (fiduciary role)
- Are you protecting shareholders? The public? What is their interest? Can that be determined without 20/20 hindsight?
- Is your obligation to "stop" clients and how: when do you need to withdraw or report them?

Reporting up/out? Sarbox 307/Model Rule 1.13

The ethical rules include responsibilities to report up under 1.13 - Post-Enron, Congress decided that state ethics rules weren't enough.

Sarbox 307 regulates attorneys "appearing and practicing" before the SEC (effectively all public company lawyers), mandating reporting

- This is law: criminal sanctions attach. [17 CFR Part 205]
- Basically codifies Model Rule 1.13 "reporting up" requirements, with some added specificity and teeth.
- Sarbox 307 dictates are now the "reasonable" standard under 1.13; so even if you're not in a public company
- Most notable: this is a wake up call ... lawyers are now responsible for executive wrongdoing.
- Sarbox Redux: new regulation given recent failures?

Business Versus Legal - are *you* the client?

- Fundamental value of IHC is their integration into the business and their intimate “knowledge” of the client – when do you move beyond objectively representing the client as independent legal counsel? - Think AKZO.
- Ethics programs for in-house counsel used to be relatively simple: we talked about how to take off your business hat and put on your legal hat.
- Now your hats are piled on top of each other for business leadership, governance, fiduciary and legal roles, but ethical regulations still assume that the hats will always be separately worn.
- Implications: professional regulation of business roles.



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Number Three: Conflicts of Interest – Internal to You/Your Company

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Conflicts (“All in the Family”)

Representing a corporate family - Model Rule 1.7
Most folks learn ‘conflicts’ issues in the law firm context: current client/past client: when you can take on a new client/matter and when you can’t.

In the corporate family context, issues arise when your work for the parent or your employer-entity entails your work with subs, affiliates and ventures - the rules suggest you can treat wholly-owned subs / affiliates as divisions of your entity-employer.

So what are the issues?

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Conflicts -Representing the Corporate Family

- How can subs' interests diverge from the employer-entity?
- Do we all agree that it's valuable to represent subs/ affiliates even when they're not wholly-owned?
- Are there measures you can consider to avoid problems and help diffuse conflicts or privilege problems that do arise? Best practices to employ?
- *BCE v Teleglobe*: Judge Ambro's excellent advice.
- Joint defense agreements / scope of representation letters

A few related conflicts considerations

- ... who's the client when financial troubles may lead to insolvency/bankruptcy?
- ... who's the client in a takeover or merger situation?
- ... who's the client in derivative litigation?

(See John Villa's excellent materials for more info...)

Conflicts: Job Mobility

We know about the strict rules regulating outside lawyers moving from firm to firm, but they apply to you, too.

- Non-disclosure and non-compete agreements:
 - Everybody signs them, but they're technically unenforceable – lawyers can't "contract out of" professional obligations
 - You shouldn't convey that you can abide by their terms
 - Is there a form that can be developed for lawyers? That contemplates the rules' requirements to retain professional independence and avoid conflicts / breaches of confidentiality?

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Number Four:
Conflicts and Waivers –
Outside counsel

And of course! The conflicts stuff you know...

- More “rule time” spent here than anywhere – are these the most important rules of ethics for lawyers? Or for the business of lawyering?
 - Model Rule 1.7 and 1.8: Current Client Conflicts.
 - Model Rule 1.9: Duties to Former Clients
 - Model Rule 1.10: Imputation – a new model rule
 - Model Rule 1.11 and 1.12: Rules for gov't. lawyers and judges
- Conflicts rules are under incredible pressure. Is reform needed? Shd sophisticated clients opt out?
- When do you grant a waiver? Never?

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Number Five:
Supervisory
Responsibility

Don't underestimate 5.1, 5.2, and 5.3 !
Your responsibility: your client's representation.

- Do you transfer responsibility for your client's work when you hire or retain others to do it? Does their individual responsibility make yours moot?
- MANAGERS are responsible for the work of subordinates, as well as their own work, and for ethical performance
 - Outside counsel you manage
 - Inside counsel you manage
 - Non-lawyers you manage, including lawyers not admitted in your jurisdiction.

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Number Six:
Suing the Client and
Retaliatory Discharge

Suing Your Employer - Your Client

- What happens when the lawyer's employment rights conflict with her duties under the rules?
 - Ex: *Balla v. Gambro* case / more recently - Toyota?
 - Cases often arise in the context of an argument over poor performance (management's view) vs. allegations of wrongdoing ignored (discharged lawyer's view).
 - Can outside counsel sue clients who fire them for any reason? Do we want our employment status to make us less attractive than outside counsel?
 - Classic conflict between professional responsibility and lawyers' personal interests: which wins? And why?

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Number Seven:

"Is it a privilege anymore?"

Confidentiality, Attorney-Client Privilege, and Work Product Protection: the basics and their erosion under duress.

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Conflicting duties come to a head: protecting attorney-client privilege

When the client entity is under the microscope, everyone expects the company and its lawyers to cooperate fully: "full frontal transparency." Does that mean producing privileged material?

An increased focus on detecting and reporting frauds and failures can make lawyers and the privilege they (cannot) protect targets of prosecutors and pariahs to clients.

When lawyers act as regulators, it's impossible to balance confidentiality, employee reliance, and stakeholder interests.

Ever-shifting sands of determining who is the client, who controls the privilege, and what is in the client's best interest at any given moment, long or short term.

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Confidentiality / Attorney-Client Privilege Defined

Confidentiality is protected under 3 distinct doctrines:



Privilege is a sub-set of confidentiality

Lawyer conduct regulations

1. ABA MRPC 1.6 - Confidentiality

Evidentiary Privileges (a client's right to exclude requested matter in a discovery dispute):

2. Attorney-client privilege
3. Work product protections

Exceptions to Privilege:

- Cannot facilitate fraud • Does not survive waiver
- Does not protect facts

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Privilege under duress:

- In the context of internal investigations
- In the context of government investigations
- In the context of multijurisdictional matters, especially multinational matters.
- In the context of financial disclosure
- In the context of work product: what are facts and what is lawyer thought process?

Reports of privilege protection problems arose in the investigatory context between 2003-08.



ACC surveys showed that when the company is under scrutiny:

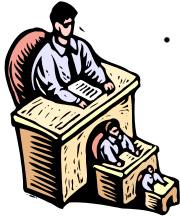
- Waiver is expected and the price of admission for leniency/survival
- Waiver requests were increasing
- Erosions in the protections of the privilege had a negative effect on preventive compliance.

Privilege in the corporate context

- *Upjohn* is the law. It acknowledges privilege in the corporate context
- Prosecutors and regulators bypass clients' rights by "requiring" waivers or deferred prosecution agreements that negate privilege rights; companies can't afford to push back
- "Just the facts": that's all investigators want, right? What about facts in A/C or W/P docs or conversations/interviews? Waiver?



Employees and Privilege



- The entity is your client, but employees act as the entity's reps so long as they are in concert with the entity's interests.
- The Thorny Problem: application of privilege to employees and their statements:
 - Corporate policies require EE cooperation
 - Balanced against 5th/6th Amendment rights
 - Presumption of innocence? Or guilt?
 - EE's lawyering up ... when should you encourage them to get their own counsel: advancement of fees, joint defense agreements
 - Who decides when an employee has left the zone of the entity's best interests?
 - Investigators target employee interviews

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US v. Stein: the KPMG Case

Illustrates how employee issues in the context of investigation can create lawsuits and liability on their own (in which counsel's advice and actions will be front and center):

- Advancement of fees
- Sharing documents
- Joint defense agreements
- Discipline/termination of targeted EEs

The Result:
KPMG is sued for doing what the government coerced its counsel to do: throw EEs under the bus.

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Privilege and work product protections raised in investigations fall outside of the courtroom context -

Today it's unlikely that there will be an impartial third party court poised to protect your client's privilege rights.

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DOJ / SEC “Cooperation” Standards

- **Holder Memo** (1999) - an effort to educate prosecutors and create a common standard: nine criteria established.
- **Thompson Memo** (2003) - a mandatory checklist for prosecutors. Waiver requests become routine.
- **Seaboard** - SEC’s cooperation standards ... other agencies following suit. Waiver assumed.
- **McNulty Memo** - DOJ Main attempts to procedurally address a problem that’s really a “field” issue.
- **Attorney-Client Privilege Protection Act of 2007/8** - focused on “push back” rights of companies, and protection of EE rights.
- **The Filip Memo (2008)** – US Attorneys Manual, the possibility of an Executive Order? Eric Holder returns to the fray....

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Is Limited Waiver the “answer”?



- DOJ/SEC would like you to think so
- FRE 502: Federal Courts’ study committee addresses the problem: a majority of courts don’t recognize limited waiver; 502 moving forward does not codify waiver, but does help in some e-discovery/inadvertent disclosure contexts
- Audit/some regulatory contexts: is disclosure really a waiver when there’s no adversary? (common interest doctrine)
- Subject matter waivers: long-term consequences.
- Third party plaintiffs.

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Number Eight:
Privilege, Confidentiality and Corporate Financial Transparency: in the Audit / Disclosure context

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Privilege Issues in the Audit Context

- **Discussing Privilege issues with:**
 - **Board Audit Committee – of course!**
 - **Internal Auditors – maybe ...**
 - **External Auditors – be careful!**
 - The ABA/AICPA “Treaty” is functionally dead.
 - Under PCAOB rules, no stone left unturned
 - Are confidences shared with auditors waived?
 - Audit results threatened/withheld or qualified/no opinion offered if full disclosures or access to confidential docs is not granted
 - Recent cases suggest plaintiffs can go around privilege rights by subpoenaing auditors



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Privilege Issues in the Financial Disclosure Context

- In-house lawyers provide counsel that:
- Helps companies create contingent liability analyses
 - Helps finance leaders understand corporate risk and exposure
 - Is relied upon by stakeholders
 - FAS 5 and IAS standards



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Privilege Issues in the Disclosure Process

- FAS 5 /141R – contingent liabilities and valuation: current / proposed rules
- Are private companies in the clear because they don't have public company reporting requirements? (nope)
- IASB (IAS 137) and the coming “global” standards of accounting practices



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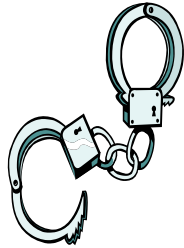
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Number Nine: Emerging Theories of Liability, Culpability, and Responsibility for In-House "Gatekeepers"

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How did we get here? What happened?

- A spate of highly publicized corporate failures: a crime spree?
- Where were the lawyers?
- Lawyers and compliance - a legal or fiduciary role/responsibility?
- Government takes action: Corporate Fraud Task Forces: sending messages to corporate America about accountability for failures



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Let's all agree at the outset:

- We're not here to suggest that lawyers should not be gatekeepers, or should be less than aggressive in their roles.
- The focus is on the difficulty in navigating your role in the Post-Enron practice environment, and on offering practical advice to avoid landmines that could land you in the crosshairs of scrutiny.
- The risk of being targeted has exponentially increased, even if it's still a relatively unusual event. The greater likelihood is that your involvement in client representation will be used to "roll" you against your client's interests.

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CLO Question: How many executive roles (such as internal team leadership or additional titles - VP, CCO, CPO, etc.) do you carry in addition to CLO?

- | | |
|--|------|
| 1. None: I'm the CLO/ general counsel only | 12% |
| 2. 1 - 2 additional roles | 36% |
| 3. 3 - 5 additional roles | 38 % |
| 4. 6 or more | 10% |
| 5. I can't count that high this fast | 4% |

Why are IHC increasingly in the crosshairs?

- Regulators/prosecutors like the idea of going after lawyers: they know the law; their violation of it is particularly distasteful.
- They're senior executives – with management's ear/trust
- They likely have unparalleled access to clients and events (though not as much knowledge as prosecutors often think)
- They often carry corporate functional (read: fiduciary or strict liability) responsibility for ethics and compliance initiatives.
- They come with strings that are more easily pulled: they're professionally regulated by defined rules and higher standards.

IHC Liability for Corporate Failures

- ACC's extensive research into this subject – (100+ pages of it in your written materials)
- Three theories of liability: culpability, "omissions," obstruction
- Increasing criminalization of corporate failures
- Lawyers and financial fraud: are we competent?
- "Advice of counsel" defenses

Criminal prosecutions of IHC

- Increasingly, the rhetoric of lawyers as “gatekeepers” is becoming reality.
- Perceptions of acceptable conduct can change.
- Big losses increase the risk of criminal prosecution.
- Wearing two or more hats carries real risks for corporate counsel.
- Wearing only one hat may be less of an excuse for ignorance than it used to be.

Criminal prosecutions of IHC, cont.

- Some recent liability experiences suggest an element of “bystander liability” for lawyers near the scene of a business disaster.
- A demonstrable ethical culture matters more today than ever: how the prosecutor is pre-disposed to view your company (essentially, as law abiding or as a rogue) is critical
- Check your license and your colleagues’ licenses so they don’t wreck you

“Gatekeeping” is a natural extension of what in-house counsel are particularly well-trained and well-situated to do.

We work in difficult times, but I believe that gatekeeping is on balance a strategic opportunity for in-house lawyering, rather than a liability.

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Number Ten: Navigating Ethics Issues in the New Legal Services Paradigm

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What to watch for:

- Supervisory roles will change and become more complex
- Fee structures will re-jigger and shift traditional incentives, risks and rewards
- Multidisciplinary teams will be offering client solutions and not all the players will be lawyers or under a lawyer's supervision; the walls between offices will melt away.
- MJP/cross-border practice concerns/solutions
- Outcome focus replaces legal quality concerns.

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Conclusions: Legal ethics and the rules of evidence don't provide much navigational or reliable guidance

Indeed, mixing legal ethics and some kinds of compliance / fiduciary responsibilities leaves lawyers exposed to unresolved and significant contradictions in their daily responsibilities.

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Thank you for your time and attention.

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