FRASER MILNER CASGRAIN LLP

To: Participants of "Staying One Step Ahead: Important Considerations for Corporate Counsel"

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Subject: Wearing Two Hats: Liability and Insurance Issues Facing Corporate Counsel

MEMORANDUM

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Introduction

> … Should we say that this corporate lawyer wears two hats? Too superficial. Serves two masters? A bit exaggerated. Is a jack-of-all-trades but a master of none? Harsh and unnecessary. Perhaps, then, he or she simply has a split personality … I prefer anatomy and geography. The general counsel has one foot planted firmly in the shifting, treacherous terrain of the law, and the other planted just as firmly in the oozing swamp of business. The result is always challenging. Every general counsel teeters one way and then the other in an endless effort to remain standing. The natural response would be to bring one's feet together more securely in one world or the other.[1]

The aim of this paper is to assist those who maintain a foothold in each of the legal and business worlds. This paper explores the boundary between legal and business advice provided by in-house counsel, and analyzes the potential liability and insurance ramifications associated with these two kinds of advice.

This paper is organized in three parts. Part I examines the evolving and expanding role of modern in-house counsel. Part II canvasses the liability and insurance issues that arise out of this expanding role, taking note of potential gaps in insurance coverage. Part III considers how in-house counsel can distinguish, both in law and in practice, between legal and non-legal roles, and includes a cautionary tale.

This paper provides a general discussion, and is not a source of legal advice. If a legal opinion or other expert advice on a particular insurance policy or situation is required, the services of a competent professional should be sought.

PART I: The Multiple Roles of In-House Counsel

I. In-House Counsel as Legal Advisor

Much of this paper deals with the issues that arise when in-house counsel do more than provide legal advice. However, before launching into these issues it is worth noting that even when corporate counsel focuses solely on providing legal advice, liability and controversy can arise.

Moonlighting, or doing work outside of and in addition to one's job, is a familiar example of this. Moonlighting in the in-house context is not limited to taking on fee-for-service work from parties completely unrelated to the corporate client. Doing personal work for employees of the corporation who do not have authority to instruct counsel would probably also be moonlighting. Moonlighting is a problem in part because the moonlighting activity may be

[1] Deborah MacNair, "The Role of the Federal Public Sector Lawyer: From Polyester to Silk", 50 U.N.B. L.J. 125, at p.128, citing an article by Timothy P. Terrell.

uninsured, especially if corporate counsel does not carry professional liability insurance (something that is discussed below).

When the personal work is done for a director or officer, the water becomes murkier, as both insurance and conflict of interest issues arise. The *Rules of Professional Conduct*[2] make it clear that in-house counsel is acting for the organization and not any of the individuals involved with that organization, including the shareholders, officers, directors and employees. While obviously the organization can only instruct the lawyer through these people, the lawyer must ensure that he or she is serving the interests of the organization. This does not preclude joint retainers in which the lawyer also represents a director or officer, for example, but corporate counsel should consider possible conflicts of interest and, where necessary, inform an individual that he or she must retain independent counsel.

II. Why Give Non-Legal Advice?

Turning to the main focus of this paper, it is worth asking at the outset: why provide non-legal advice at all? Focussing exclusively on legal advice would keep corporate counsel squarely within her professional expertise, and would simplify insurance and other issues. Yet, few in-house counsel, and perhaps no general counsel, are choosing to adopt such a focus. One author sets out four roles typically occupied by the modern general counsel:

> (1) Legal advisor within the corporation to its constituents in an individual professional capacity;
>
> (2) Officer of the corporation and member of the senior executive team;
>
> (3) Administrator of the corporation's internal (or "in-house") legal department; and
>
> (4) Agent of the corporation in dealings with third parties, including external (or "outside") counsel retained by the corporation.[3]

While 2, 3 and 4 will not apply to most in-house counsel who are not general counsel, many of these corporate lawyers will be managers and will provide business advice within the corporation.

[2] Law Society of Upper Canada, *Rules of Professional Conduct*, Commentary to Rule 2.02, concerning quality of service, and in particular to Rule 2.02(1.1), concerning organizational clients [Rules].
[3] See Deborah A. DeMott, "Colloquium: Ethics in Corporate Representation: The Discrete Roles of General Counsel," 74 Fordham L. Rev. 955, at pp.957-958 [DeMott].

1. Professional Duty and the Nature of the Corporate Client

This provision of business advice may be an explicit or implicit job requirement for some, but it does not flow from a professional duty. Sometimes, when representing an unsophisticated client, for example on an investment deal, a lawyer will owe a professional duty to provide some minimal amount of basic business advice to steer the client away from the most disastrous schemes. The existence of this obligation generally depends on the nature of the relationship between the lawyer and the client, the scope of the retainer and the sophistication of the client in business matters.[4] For most in-house counsel, the corporate client has directors and officers who are selected for their business acumen. It therefore follows that corporate counsel are under no professional obligation to provide business advice, let alone make business decisions.

2. The Expanding Role of In-House Counsel

Although the provision of business advice by in-house counsel is not a professional requirement, it has increasingly become a job requirement. A survey of CEO's in 1993 revealed that even in those days, top management looked to corporate counsel to take an active role as members of the management team.[5]

Added to this, during the 1990s and continuing today, larger corporations have been shifting more and more work from outside law and accounting firms to in-house counsel, partly in an effort to control outside legal fees. As a result, corporate counsel are increasingly involved in all aspects of the business and assume "quasi-legal" roles.[6]

Interestingly, the current power and responsibility enjoyed by in-house counsel is reminiscent of what it was in the late nineteenth century through to the 1930s. During that time general counsel were often among the three most highly paid individuals in a corporation. Through the 1940s and onwards, the status of general counsel diminished as large law firms took over increasingly more corporate legal work, and marketing and finance people displaced general counsel as top contenders for CEO.[7] The last several decades have seen an increase in the power, responsibility, income and prestige of in-house and especially general counsel.

As Anna K. Fung, Q.C., Senior Counsel to Terasen Inc., puts it:

> When we went through law school, we were all cautioned that lawyers must never stray to providing business advice if we were to maintain our independence and professionalism as lawyers. As all of us who have since chosen to take on the role of corporate

[4] See Stephen M. Grant and Linda R. Rothstein, *Lawyer's Professional Liability*, 2nd ed. (Toronto: Butterworths Canada Limited, 1998), at pp.122-123 [Grant and Rothstein].
[5] See Joyce Borden-Reed, "CEO's Expect Counsel to be informed Contributors," 3 Can. Corp. Counsel 35; November/December 1993.
[6] Amy Weiss, "In-house Counsel Beware: Wearing the Business Hat Could Mean Losing the Privilege", 11 Geo. J. Legal Ethics 393.
[7] See *DeMott*, above, for a discussion of the history of corporate legal departments.

> counsel now know, while we may have been initially hired to provide legal advice and handle the corporation's myriad of legal problems, inevitably as the employer's level of trust with us grows, we are expected to do much more than be legal technicians. In today's business environment, most corporate counsel are hired to carry out at least one or more of a multitude of business roles: risk manager; human resource manager; educator; lobbyist; compliance officer; privacy officer; corporate secretary; director; and ethics officer.[8]

The Law Society of Upper Canada has also recognized the value that lawyers can add outside of their legal expertise:

> In addition to opinions on legal questions, the lawyer may be asked for or may be expected to give advice on non-legal matters such as the business, policy, or social implications involved in the question or the course the client should choose. In many instances, the lawyers' experience will be such that the lawyers' views on non-legal matters will be a real benefit to the client.[9]

While corporate lawyers (both in-house and outside) are likely to gain business experience that is unrelated to their legal training, it is also likely that a lawyer's training will itself provide valuable insight and structure to business decision-making. For example, in-house counsel can play a crucial risk-management role in the corporation's business decisions. For this, they must "think like managers."[10] To accomplish this, corporate counsel must resist the urge to eliminate risk, and become experts in calculating, mitigating and managing risk. This, in turn, may even mean managing the CEO. Participants at a Canadian Corporate Counsel Association session discussed the necessity of helping CEO's who shoot from the hip to avoid making costly mistakes. In-house counsel may be more acutely aware of the risks facing the company, and may be in the best position to perform this role of "elephant keeping."[11]

3. The Opportunity for Proactive Guidance

While providing non-legal advice may not be required by the profession, it may help corporate counsel further the profession's values. Corporate counsel are frequently asked not only for advice on the best business approach, but also for advice on the moral or social implications of certain company decisions. As Gavin MacKenzie puts it, "corporate lawyers are sometimes treated as the company's conscience".[12] Of course, lawyers do not have a monopoly

[8] Anna K. Fung, Q.C., "CCCA 17th Annual Meeting, August 14, 2005, Vancouver, B.C., Workshop No. 203 – Corporate Counsel Ethics," at p.8.
[9] *Rules*, above, Commentary to Rule 2.01(1).
[10] R. Marc Mercier and Riccardo C. Trecroce, "Juggling Professional Duty and Client Loyalty: The Art of Corporate Counselling," 3 Can. Corp. Counsel 81; April/May 1994, at p.85.
[11] See Oliver Bertin, "Managing Risk at Heart of GC Role," 24 Lawyers Wkly. No.48 6(2), at p.6.
[12] Gavin MacKenzie, *Lawyers and Ethics: Professional Responsibility and Discipline*, loose-leaf, (Toronto: Carswell, 1993) at p.20-6 [MacKenzie].

on the ability to tell right from wrong, but given the nature of legal education, the good character requirement for entry into the profession, and the ongoing adherence to ethical standards, it is natural for corporate clients to look to their lawyers for ethical guidance.

This role for corporate lawyers is also recognized by the Law Society of Upper Canada in the *Rules of Professional Conduct*:

> These rules recognize that lawyers as legal advisers to organizations are in an essential position to encourage organizations to comply with the law and to advise it is in the organizations' and the public's interest that organizations do not violate the law. Lawyers acting for organizations are often in the position to advise the executive officers of the organization not only about the technicalities of the law but about the public relations and public policy concerns that motivated the government or regulator to enact the law. Moreover, lawyers for organizations, particularly in-house counsel, may guide organizations to act in ways that are legal, ethical, reputable, and consistent with the organization's responsibilities to its constituents and to the public.[13]

In other words, up-the-ladder reporting and whistle-blowing, though featured heavily in the media, are not the only ways or the best ways for corporate counsel to influence corporate conduct. In-house lawyers have a more proactive role to play. In developing policies, codes of conduct and in establishing ethical standards, in-house counsel should raise their sights above the bare minimum of legal compliance.[14]

Finally, job requirements and professional considerations aside, providing sound business advice may help further the career of in-house counsel. A corporate lawyer has the opportunity to learn the whole business, and general counsel in particular will often have direct access to the CEO and the board members, who may see a lawyer's willingness and ability in the business arena as a sign that she is ready for higher management positions.

III. Pitfalls of Giving Non-Legal Advice, Other Than Liability

There is a consensus that "the ethical duties of [in-]house counsel and outside counsel seldom, if ever, differ."[15] Both must consider potential conflicts of interest, the extent to which they can work for employees of their clients, and other issues. Some believe, however, that corporate counsel may be more susceptible to erosion of their independence.[16] The more involved with the client's goals and the more loyal corporate counsel becomes, so the story goes,

[13] *Rules*, above, Commentary to Rule 2.02 (5.2).
[14] See Arthur B. James, "The CEO must engage counsel as a force in corporate policy," 3 Can. Corp. Counsel 37; November/December 1993.
[15] *MacKenzie*, above, at p.20-1.
[16] Discussed in *MacKenzie*, above, at p.20-1.

the greater the potential for a lawyer to lose her objectivity. This is exacerbated by the reliance of most in-house lawyers on the corporation for their livelihoods and successful careers. This has led some to argue that in-house counsel who are involved in strategic planning should not also be the lawyers who evaluate the resulting plans; outside counsel should be retained.[17]

Others view this concern as overblown. One author cites a Canadian study from 1986 and 1987 in which one-third of in-house counsel identified more with the legal profession than with their organization, one-third identified more with their organization, and the final third were ambivalent. This is hardly a picture of unchecked loyalty to the corporate client. The author in question is of the view that a similar survey of outside counsel would produce similar results.[18]

There is no need to settle this debate here. Suffice to say that when giving any advice, legal or otherwise, "[a] lawyer should be wary of bold and confident assurances to the client, especially when the lawyer's employment may depend upon advising in a particular way."[19]

PART II: Liability and Insurance Issues

Various potential liabilities attach to the different hats worn by corporate lawyers. A corporate lawyer can be increasingly sure that whatever she does at work, potential liability accompanies her. Whether she has insurance to match this liability is another matter, and an open question. There are four types of insurance on which the corporate lawyer might try to rely for coverage, all of which are considered in this Part:

1. Professional liability errors and omissions (E&O) insurance. This may include insurance offered by a law society (e.g. LPIC, now known as LAWPRO), and excess insurance.

2. Professional liability E&O insurance that is specially tailored to in-house counsel.

3. Directors and officers (D&O) insurance.

4. The corporation's general liability insurance (CGL).

In reality, if corporate counsel is to be covered for all job activity, including legal and non-legal advice, this will only be accomplished through some combination of these different policy types. The question is whether most corporate counsel are fully covered without gaps, and whether this is even possible.

[17] See Joseph Auerbach, "Can Inside Counsel Wear Two Hats," Harvard Bus. Rev., September-October, 1984, at p.80.
[18] *MacKenzie*, above, at pp.20-2 and 20-4. See also Mercier and Trecroce "Juggling Professional Duties and Client Loyalty: The Art of Corporate Counselling – Part 2," 3 Can. Corp. Counsel 100; June/July 1994, at p.100.
[19] *Rules*, above, Commentary to Rule 2.01(1).

I. Insurance for Legal Advice

1. Professional E&O

Each provincial law society insures its members against negligently giving or failing to give legal advice. Ontario's regime, LAWPRO, is administered by the Law Society of Upper Canada's insurance company, the Lawyers Professional Indemnity Company (LPIC). In some provinces, in-house counsel are specifically and entirely excluded from coverage, and until January 1, 1997 in Ontario, in-house lawyers were covered but not for claims brought by their employers. Now corporate lawyers can be covered for claims by their employers for professional services.[20] However, while coverage is mandatory for members in private practice, in-house counsel can be exempted if they provide legal advice only to their sole employer.[21] In-house lawyers who do a limited amount of fee-for-service work outside of their in-house practice may qualify for a part-time discount.

Were in-house counsel to obtain professional liability insurance, practically speaking, corporate clients would end up paying the premiums. Corporate clients may be willing to indemnify their in-house lawyers in order to eliminate this cost. Such indemnities and the employment contracts they accompany must be drafted with care. If the agreement between in-house counsel and corporate client resembles a fee-for-service agreement (i.e. if it resembles agreements made between lawyers in private practice and their clients), an indemnity might be caught by s.22 of the *Solicitors Act*.[22] This section renders void any provision in a fee-for-service agreement between solicitor and client that seeks to eliminate the solicitor's liability for negligence. However, indemnification of a lawyer in a master-servant relationship is expressly excepted from this prohibition.[23]

2. Employed Lawyers Professional Liability Insurance

Several insurers provide professional liability insurance aimed specifically at in-house counsel. For a number of years Chubb has teamed up with the Association of Corporate Counsel (formerly the American Corporate Counsel Association) to offer Employed Lawyers Professional liability insurance. More recently, this insurance has become available in Canada. Insurers currently offering this type of insurance include Chubb, AIG, ACE INA, Arch, and Lloyd's syndicates.[24] The ACC provides the following rationale for the provision of such insurance: "[a]s cost-conscious companies seek to have in-house counsel perform services traditionally delegated to law firms, corporate attorneys face increasing liability exposures, especially to non-client third parties."[25]

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[20] See *Grant and Rothstein*, above.
[21] *Pro bono* practice is also covered, provided that it meets certain requirements.
[22] R.S.O. 1990, c.S.15 [Solicitors Act].
[23] See Joseph M. Steiner, "Professional Liability of Corporate Counsel," 2 Can. Corp. Counsel 113; July/August 1993, and the *Solicitors Act*, above.
[24] Chubb marketing materials, provided by Matthew Davies, Canadian Manager - Professional & Media Liability Chubb Specialty Insurance, Chubb Insurance Company of Canada (Toronto), November 10, 2006.
[25] Association of Corporate Counsel website: http://www.acca.com/.

This is E&O coverage for legal malpractice. It is intended to provide coverage where standard lawyers' E&O coverage falls short or where the lawyer has obtained an exemption. It does not cover non-legal decision-making or advice. A representative at Chubb points to the following main distinctions between commercial market employed lawyers insurance and LAWPRO insurance for in-house counsel:[26]

> 1. Employed lawyers insurance covers the lawyer regardless of where she is called to the bar and regardless of where she is practicing. For example, in-house counsel employed by an Ontario company would be covered for filing at the NASDAQ and appearing before the SEC.
>
> 2. Employed lawyers insurance takes into account indemnities. If in-house counsel is not indemnified due to financial impairment of the corporate employer, the lawyer pays the deductible and receives the benefit of the policy. If in-house counsel is indemnified, the employer pays the deductible and receives the benefit.
>
> 3. Employed lawyers insurance provides coverage up to $5,000,000, compared with LAWPRO in-house coverage of $250,000. LAWPRO provides an option to increase coverage to $1,000,000 per claim / $2,000,000 aggregate. Of course, excess insurance can be bought in other markets regardless of whether the lawyer is covered by LAWPRO or employed lawyers insurance.
>
> 4. Employed lawyers insurance coverage can be expanded to apply to consultants contracting with a company's legal department, paralegals, and certain other non-lawyers.
>
> 5. Employed lawyers coverage is somewhat more expensive than LAWPRO coverage.

3. CGL

As a rule, in-house counsel will not be able to rely on the corporate client's CGL policy for professional liability coverage. The intent of the CGL is to "carve off" this area of liability.[27] As one commentator explains:

> Commercial liability policies are not intended to provide coverage for professional liability. Insurance in respect to professional liability is available separately from underwriters who specialize in

[26] Conversation with Matthew Davies, Canadian Manager - Professional & Media Liability Chubb Specialty Insurance, Chubb Insurance Company of Canada (Toronto), November 10, 2006.
[27] Heather A. Sanderson, Robert D.G. Emblem and J. Lyle Woodley, *Commercial General Liability Insurance*, (Toronto: Butterworths Canada Limited, 2000), at p.71 [Sanderson, Emblem and Woodley].

> that market, often at the substantially higher premium than that associated with the ordinary commercial risk.[28]

While only some CGL policies explicitly exclude coverage for professional services (typically through an endorsement), most or all exclude this coverage through the interaction of several restrictions in the policy. Chief among these is the restriction to coverage for bodily injury and damage to property. This effectively excludes traditional professional negligence claims, which are claims for economic loss. Although a CGL will generally provide cover for professional negligence where the claim is for bodily injury, this will be of little comfort when the claim is for the cost of redoing the lawyer's work or undoing a mistake with economic consequences, which will almost always be the case for in-house counsel faced with a suit.

II. <u>Insurance for Non-Legal Advice</u>

1. Professional E&O

Professional E&O policies contain wording that define the professional services covered. Depending on the wording, these definitions themselves may effectively exclude non-legal advice and decision-making.[29] These policies also typically exclude claims arising out of the insured's activities as an officer or a director.[30] As an indication of the narrow nature of these policies, "lawyers acting as executors, administrators, trustees, personal representatives, committees, guardians and patent or trademark agents will be covered by their professional liability policy only if they can establish that the services are in keeping with those usually provided by a solicitor."[31] Furthermore:

[28] Gordon Hilliker, Q.C., *Liability Insurance Law in Canada*, 4th ed., (Toronto: LexisNexis Canada Inc., 2006), at p.200 [Hilliker], citing the decision in *Foundation of Can. Engineering Corp Ltd. v. Can. Indemnity Co.*, [1978] 1 S.C.R. 84, [1977] 2 W.W.R. 75 as authority for this point.
[29] According to Lysyk and Sossin, the definition of "professional services" is similar across the polices of the professional indemnity insurers in Canada: "The Ontario policy defines it as "the practice of the Law of Canada, its provinces and territories" which were or ought to have been performed "in the insured's capacity as a lawyer." The definition in the CLIA policies refers to "services normally provided or supervised by a lawyer within the scope of a usual lawyer-client relationship…and incidental services that are substantially related to service normally provided or supervised by a lawyer." The CLIA policy specifically states that professional services do not include "ancillary" activities. These are defined as activities of a "quasi-legal or non-legal nature, such as financial, investment and accounting services, brokerage services, real estate development and appraisals. The Courts have suggested that a "professional service" is one that involves "both a mental or intellectual exercise within a recognized discipline and appreciation of special skill, knowledge and training to the particular function."" See: The late Justice Kenneth Lysyk (D. 2003), Lorne Sossin, and Jeffrey G. Hoskins, General Editors, *Barristers & Solicitors in Practice*, loose-leaf, (Toronto: LexisNexis Canada Inc., 2006), at p.14.7 [Lysyk and Sossin]. The authors quote from *Chemetics International Limited v. Commercial Union Assurance Co. of Canada* (1981), 31 B.C.L.R. 273 at 286 (S.C.); affd. (1984) 55 B.C.L.R. 60 (C.A.). Lysyk and Sossin note (at page 14.7) that the question of whether a professional service was rendered by a lawyer in a given situation is a question of fact. This involves looking beyond the title of the job and examining the activity carried out by the person in question.
[30] See *Hilliker*, above, at p.298. See also Alan I. Bossin, "In-House Counsel Facing Increasing Liability Risks," 4 Can. Corp. Counsel 67; March 1995 [Bossin].
[31] *Lysyk and Sossin*, above, at p.14.8.

> Professional liability or error and omission policies are typically geared to indemnify against the financial cost of undoing an error in judgment, not the cost attendant upon the occurrence of property damage or bodily injury. It is common for these policies to plainly exclude property damage and bodily injury or such risks are intended to be borne by a CGL.[32]

Thus in some cases, E&O policies complement D&O and CGL policies without much overlap.

2. D&O

As the name suggests, directors and officers policies are designed to insure the small number of people who sit at the top of the management structure of a corporation. In practice, the corporation will pay for the insurance.

The wording of the policy itself will set out who qualifies as an officer or director. In many corporations the general counsel is a corporate officer and appointed to the board of directors by virtue of her office.[33] Importantly, however, in-house counsel who are not general counsel will usually not be directors or officers. A person's job title may not be determinative. The courts have held that the question of who is an "officer" will depend on the context.[34] In some cases employees who are neither directors nor officers may be insured.

In-house counsel, and especially general counsel, would be well advised to be covered by a D&O policy if possible. They will be in good company:

> [I]t has become increasingly common for companies to purchase [D&O] insurance. In view of a number of well known cases in recent years where directors and officers have been sued, it is not surprising for the demand for such insurance has grown. Indeed, as a practical matter, it will be increasingly difficult for companies to attract qualified individuals to sit on their boards without procuring D&O insurance.[35]

D&O insurance provides, of course, incomplete coverage for in-house counsel. Even when a general counsel is a director, not all of her decisions will be covered by D&O insurance because "[c]overage for directors and officers is limited to wrongful acts committed by them while acting solely in the capacity of director or officer"[36] and certain legal services provided may not qualify as management decisions.[37]

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[32] *Sanderson, Emblem and Woodley*, above, at p.93.
[33] See *DeMott*, above, at p.967.
[34] See the discussion in *Sanderson, Emblem and Woodley*, above, at p.114.
[35] *Sanderson, Emblem and Woodley*, above, at p.111.
[36] *Hilliker*, above, at p.279.
[37] See *Bossin*, above.

III. Special Liability Issues for In-House Counsel

1. The SEC and the OSC: Targeting In-House Counsel Both as Principals and as Gatekeepers

In a speech in Pebble Beach, California on April 28, 2005, Giovanni P. Prezioso, General Counsel to the U.S. Securities and Exchange Commission (SEC), drew a distinction between corporate counsel as principals and corporate counsel as gatekeepers.[38] As principals, corporate counsel (and general counsel in particular) can be sanctioned by the SEC for committing an act or omission that, if done by another person, could give rise to sanctions. For example, the SEC will not hesitate to punish a lawyer who engages in insider trading. Her status as a lawyer cannot shield her from enforcement action.

In addition to this, the SEC will also target lawyers as gatekeepers, as a way of providing leverage to enforcement efforts. The SEC's strategy in this regard is to keep companies honest by keeping their general counsel (and legal department) honest. As one reporter puts it, "agencies such as the SEC are sending a message that they will prosecute those lawyers [who] are essentially too creative with legal advice."[39]

A recent example of this strategy is the Google case. On January 13, 2005, the SEC charged Google for failing to register stock options issued to employees prior to an initial public offering. This did not result in any harm to the recipients of the IPO. Google's general counsel, who was of the view that Google was exempt from the requirements in question, was the only individual charged. He and Google settled the charges without admitting or denying the findings, and also settled a related civil action.[40]

Through the Google case, the SEC has sent the following messages:

> (i) no violations of law are minor, and the cost of violating the securities laws cannot be measured simply by civil litigation costs;
>
> (ii) the quality of legal advice and diligence of the lawyer will be factors in an enforcement review if the SEC staff believes the advice was wrong; and
>
> (iii) lawyers who chart risky legal strategies for their corporate clients without fully describing those risks to directors approving transactions may be deemed to have made the business decisions themselves rather than merely to have rendered advice.[41]

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[38] This speech is reproduced in Dennis O. Garris, et al, Co-Chairs, *Gatekeepers Under Scrutiny: What Attorneys, Accountants and Directors Need to Know Now,* (New York: Practicing Law Institute, 2005) at p.543 [Garris].
[39] Jacquie McNish, "Next up for Prosecutors: Corporate Lawyers," Globe and Mail, September 27, 2006, at p.B14.
[40] See Dixie L. Johnson, "SEC v. The Lawyers: The Google Chapter," in *Garris*, above, at p.759.
[41] *Garris*, above, at p.761.

This last point is particularly relevant to the discussion in this paper. When seeking the board's approval, Google's counsel apparently failed to disclose to the board the legal risks of the proposed course of action. As one author explains, this precedent requires in-house counsel to balance the pros and cons of disclosure to the board:

> [B]y positioning himself as the only person who knew the risks, in the SEC's eyes, he seems to have stepped out of his lawyering role, essentially making the decision for the company. The Google order suggests that, if a lawyer seeks board approval for a transaction he or she knows carries a significant risk of being deemed in violation of the law if it were ever reviewed, the lawyer should communicate that risk clearly to the board. Taken to an extreme, the case could be read to suggest that every lawyer seeking board approval for anything risks personal responsibility for the board's approval if the lawyer does not fully describe all of the underlying legal analysis and every potential risk accompanying the approval. Yet, lawyers who cannot serve as a useful filter when providing legal analysis to the board will generally be viewed as unhelpful. To be valuable to directors, lawyers must provide sufficient information and analysis to enable them to make good decisions. Particularly if a legal strategy is risky, Google suggests that inside counsel should err on the side of providing more information to directors so that their decision can be fully informed.[42]

The SEC's policy is probably fairly effective. By pursuing gatekeepers the SEC may be able to achieve more compliance than by pursuing every wrongdoer. We might expect the Ontario Securities Commission (OSC) to pursue a similar strategy. This avenue is open to it. In *Wilder* v. *Ontario (Securities Commission)*[43] a lawyer was reprimanded for deliberately misleading the OSC in a report of due diligence results. The lawyer and the law society tried to argue that the law society has exclusive jurisdiction over the discipline of lawyers. The Ontario Court of Appeal decided in favour of the Securities Commission, holding that nothing in the *Law Society Act* immunizes a lawyer from proceedings before the Commission solely because she is acting in a professional capacity. While this case involved a lawyer in private practice, the court referred to lawyers generally, and so this decision would apply equally to in-house counsel.

2. The Spectre of Dual Liability

Lawyers who are also directors have additional concerns. Courts will not generally question the judgement of directors so long as they act in good faith and do not breach fiduciary obligations or statutory duties. Courts recognize that they are not well-equipped to evaluate business decisions. However, a director who is also a lawyer will be held to a higher standard because of her professional expertise. Thus, a general counsel who sits as a director can be held responsible both as a professional and as a director, the latter responsibility involving a higher

[42] *Garris*, above, at pp.762-763.
[43] (2001), 197 D.L.R. (4th) 193.

standard of care than that of her non-lawyer colleagues on the board. This is not unique to in-house counsel; it applies to any lawyer-director.[44]

PART III: How to Know, What to Do, and What Not to Do

I. The Line Between Legal and Non-Legal Roles

Prezioso provides a useful guide to determining when a lawyer is giving business advice or legal advice:

> In thinking about whether a lawyer has crossed the line – becoming more of a decision-maker or counselling a course of conduct, rather [than] acting as a legal advisor – a key indicator, not surprisingly, will be the extent to which the lawyer in fact gave anyone else at the company legal "advice" on the relevant issue. If the lawyer provides the CEO with a balanced legal view and the CEO then disregards the implications of that view, there may be legitimate questions about the lawyer's obligations as a professional. In such a case though, rarely will the lawyer be viewed as primarily, or even secondarily, liable under the securities laws absent further participation in the misconduct. On the other hand, if a lawyer makes a legal judgment about an issue that cannot fairly be viewed as immaterial and fails to inform anyone else at the company of the potential legal risks – in other words, if the lawyer doesn't advise anybody about anything – it will be much more difficult to argue that the lawyer played a purely advisory role. Rather, the lawyer's continuing participation in the activity without providing advice to others may, in some cases, constitute part of a course of conduct that effectively makes the ultimate business decision for the company.[45]

Also of potential relevance is the distinction made in some American cases between administrative acts and professional acts.[46] In one case, a psychiatric hospital decided to save money on its window screens. A psychiatric patient jumped to her death through one of the windows. It was alleged that the hospital was negligent both in supervising the patient and in deciding how to protect the windows. The Texas Court of Appeal held that the decision over how to protect the windows was an administrative, business decision, and not a professional decision. This meant that the exclusion in the CGL policy for professional services did not apply, and the hospital was insured for that decision. In contrast, if the hospital was negligent in supervising the patient, this would not be covered by the insurance. In another case, a veterinarian was bitten by a cat on two occasions, causing the employee to prolong a sick leave.

[44] For a discussion of the dual liability issue, see Vern Krishna, "Liability of Professionals in Business Decisions," 14 Can. Current Tax 124; August 2004.
[45] *Garris*, above, at p.546.
[46] This is discussed in *Sanderson, Emblem and Woodley*, above, at p.103.

It was held that the decision not to provide certain protective gloves, and the decision to ask an employee to return to work early from sick leave, were business decisions and not decisions relating to the veterinarian's profession. Thus the veterinarian's professional malpractice policy did not cover the alleged negligence. Although these cases did not concern lawyers, they can provide an instructive analogy.

A number of cases consider the question of when a lawyer is acting in her capacity as a lawyer. Although these generally involve outside counsel, the principles involved could be applied in the in-house context. In *Ross v. American Home Assurance Co.*,[47] the plaintiff lawyer Ross had been sued by a client over misrepresentations Ross allegedly made as to the anticipated market performance of stocks the client purchased in a company of which Ross was a director. The defendant insurer provided D&O coverage to the company. The court held, partly because the company was not named in the pleadings, that the plaintiff in the original proceedings (the client) did not intend to sue Ross as director, and thus no D&O coverage was available. Although this decision was fairly specific to the pleadings, it is a useful reminder that, at least at the pleadings stage, insurance claimants can affect whether a lawyer is sued in her role as lawyer or in another role, and this in turn will influence an insurer's stance on coverage.

In the American case of *H.M. Smith* v. *Travellers Co.*[48] the insured lawyer convinced the client to provide money to the lawyer to invest. When the client sued him, the lawyer asserted that his E&O insurance provided coverage, but the court decided for the insurer, holding that because the investment did not require legal skill or legal training, the lawyer was not acting in his capacity as a lawyer. Under the American test, a lawyer retained for non-legal services will be held not to have been acting in her capacity as a lawyer, even if the work in question did involve some use of her legal training and knowledge of the law.

In the Canadian case *Hazelwood* v. *Travellers Indemnity Co. of Canada*,[49] the plaintiff lawyer had been involved in receiving and disbursing money on behalf of investors. Following the defrauding of the syndicate on behalf of whom the lawyer was acting, the lawyer made good the loss and sought indemnification from his insurer. The British Columbia Supreme Court held that the lawyer could not be indemnified because he was acting as a broker or commission agent and not as a lawyer. The court noted that the plaintiff lawyer had received a fee which "far exceed(ed) that which he could have taxed for solicitor's services."[50] The court also noted that the solicitor had been paid as a percentage of the monthly interest payable to his clients from the investment. This is not the manner in which legal fees are normally calculated.

Brumer v. Gunn[51] stands for the proposition that a solicitor who holds herself out as competent to give investment advice must meet the standard of a reasonably competent investment counsellor. This can be stated more generally: if a solicitor provides advice of a non-legal nature, the solicitor must ensure that he or she possesses the necessary competence to do so.

[47] (1999) O.J. no. 1558 (S.C.J.), affd [1999] O.J. no. 4262 (C.A.).
[48] 343 F. Supp. 605 (U.S. Dist. Ct., 1972).
[49] [1978] 1 W.W.R. 93 (B.C.S.C.), affd [1979] 2 W.W.R. 271 (C.A.).
[50] *Grant and Rothstein*, above, at p.201, citing the court.
[51] [1983] 1 W.W.R. 424 (Man. Q.B.).

In-house counsel who serve as corporate secretaries should consider the various tasks that make up that role and ask which of these are legal in nature:

> Functions [of a corporate secretary] include: the issuing of notices or directors' and shareholders' meetings; the preparation of agenda and supporting documentation for meetings, including forms of proxy and circulars; attendance at meetings of directors and shareholders and the taking of minutes; maintaining the minute book, shareholder registers, and other corporate records; and the preparation of resolutions and similar corporate documentation. Bearing these functions in mind, it is clearly difficult to situate the point in which the satisfaction and the duties of the office of corporate secretary amounts to the delivery of professional legal services. This difficulty is compounded when the role of corporate secretary is performed by corporate counsel.[52]

In *Kerr v. Law Profession Indemnity Co.*,[53] Kerr was a solicitor insured by the insurer. He was also secretary of the corporation. As solicitor, he would be covered by E&O insurance, but as corporate secretary, he would not be covered. As the court put it at paragraph 17:

> [P]ut simply, if the claims of breach of duty made against the appellant are linked, as they are by the amendments, to his retainer as NBS's corporate solicitor, quite apart from his appointment as NBS's corporate secretary, LPIC will have to indemnify the appellants, up to policy limits, if those claims are established.

In *Toronto Dominion Bank v. Leigh Instrument Limited (Trustee of)*,[54] Winkler J. of the General Division had to consider whether the bank's senior vice president, general counsel and secretary was acting as a lawyer or as an officer when he sent a memo to the bank's branches. The court found that the particular document in question was a statement of corporate policy, and not legal advice. As a corollary, the document was circulated by the lawyer in his capacity as a business executive rather than as a solicitor. The court went on to find that the document was not intended to be treated as confidential and was not privileged.

Winkler J. acknowledged the "deep roots" of solicitor and client privilege in the British common law, but also noted its limits, citing the following passage by the Supreme Court of Canada in *Solosky v. The Queen*:[55]

> There are exceptions to the privilege. The privilege does not apply to communications in which legal advice is neither sought nor

[52] Carolyn Stanegna, "The Lawyer as Corporate Secretary", 4 Can. Corp. Counsel 17; 1994.
[53] [1994] O.J. no. 2, 22 C.C.L.I. (2d) 28 (Gen. Div.), revd, (1995) O.J. no.2823, [1995] I.L.R. 1-3250 (C.A.).
[54] (1997), 32 O.R. (3d) 575 (Gen. Div. [Commercial List]) [Toronto Dominion].
[55] [1980] 1 S.C.R. 821, at p. 835.

> offered, that is to say, where the lawyer is not contacted in his professional capacity.

Winkler J. noted that privilege will apply to communications between an in-house lawyer and the corporation, provided that the usual criteria for a finding of privilege are met. As part of this, he emphasized, a finding of privilege depends on a finding that the lawyer was acting as a lawyer:

> The law on this point is clear. In order for a communication from an in-house lawyer to attract solicitor-client privilege, it must have been made while he or she was acting in their capacity as such.[56]

Practically speaking, this means that communications will be privileged "if they concern the employee's function as a lawyer," and not "if the lawyer is performing a business or other function."[57]

Read broadly, *Toronto Dominion* reflects the current trend of eroding privilege. In-house counsel recently surveyed by the ACC expressed pessimism regarding this trend. They felt that "privilege protection most likely will not exist when they need it most."[58] More specifically, *Toronto Dominion* sheds light on the distinction between the legal and non-legal roles of in-house counsel. In this case the general counsel performed several executive roles in addition to his role as legal advisor. The court found that the document in question was "a statement of corporate policy concerning business risks associated with comfort letters and their consequent acceptability to the Bank as security." Factors that led to this conclusion were the fact that the general counsel could not say who drafted the document, or even whether it was drafted by a lawyer, and the title of the document was "Head Office Circular," in contrast to a typical legal memorandum.[59]

II. <u>The HP Scandal</u>

The recent Hewlett Packard (HP) scandal illustrates some of these issues. On October 4th 2006 the California Attorney General brought criminal charges against several high-level people at Hewlett-Packard, including former chair Patricia Dunn and Kevin Hunsaker, a former corporate counsel. The former general counsel to whom Hunsaker reported, Anne Baskins, has not been charged.

By way of background, starting in 2005, information regarding high level decisions at HP was being leaked to the media. The chair asked the legal department to find out who was leaking the information. Baskins assigned Hunsaker to investigate. He did so, by hiring outside investigators and engaging in improper investigative techniques. One of these was a tactic known

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56 *Toronto Dominion*, above, at para.25.
57 *Toronto Dominion*, above, at para.25, citing Saunders J. in *Mutual Life Assurance Co. of Canada v. Canada (Deputy Attorney General)* (1988), 28 C.P.C. (2d) 101 (Ont. H.C.) at 104.
58 Sandra Rubin, "Privilege under assault: Auditors and regulators are both knocking on the door. What to do?" National Post, November 1, 2006, p.FP8 [Rubin], citing Stephen Cannon, ACC's privilege counsel, who oversaw the survey.
59 *Toronto Dominion*, above, at para.26.

as "pretexting," in which an investigator falsely assumes the identify of a person in order to obtain telephone records.[60]

Importantly, at one point Hunsaker is said to have asked the private investigator he had hired what methods he was using to obtain phone records. The private investigator explained, and in response, Hunsaker allegedly replied: "I shouldn't have asked."[61] The details of the scandal were made public following the resignation of a board member (not the person responsible for the leaks) who objected to the investigation.

Numerous issues arise out of this situation. Among them is the question of to what extent Hunsaker acted as a legal advisor. As a legal advisor, he should have fully ascertained the nature of the investigative methods being used, examined their legality, and reported their associated risks to the directors or officers of the company. Had he felt that he had become too involved in the investigation to remain objective, he could have sought an opinion from respected outside counsel. Instead, he allegedly adopted a "don't ask, don't tell" policy, and approved the activity of the outside investigators. Based on this, he was acting more like a decision-maker than a legal advisor.

III. Recommended Practices

While line-drawing can be a difficult exercise, the practices recommended by commentators to in-house counsel tie into one main goal: carefully and clearly distinguishing legal from non-legal advice. In fact, the *Rules of Professional Conduct* make this a requirement. With regard to non-legal advice, "[t]he lawyer who expresses views on such matters should, where and to the extent necessary, point out any lack of experience or other qualifications in the particular field and should clearly distinguish legal advice from other advice."[62] This distinction can be aided by using different letterhead for legal advice, and by keeping legal files (whether hardcopy or electronic) separate from non-legal files, even when they pertain to the same matter. The deliberate mental movement between legal and non-legal analysis of the same issue (which can be reinforced by the physical act of putting away one folder and opening another) can help in-house counsel discipline her thinking processes and always be sure whether she is speaking as a lawyer or in another role.

Conclusion

The line between legal and non-legal roles was at issue in *Toronto Dominion*, and, with more serious consequences, in the HP scandal. Both these cases illustrate the risk of in-house counsel wearing multiple hats, and raise again the question of whether in-house counsel should bring their feet together more securely in either the legal world or the business world. Indeed, this appears to be the path chosen in many parts of Europe:

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[60] See Henry E. Hockeimer Jr., "HP Scandal Shows "Don't Ask, Don't Tell" Policy is Not a Good One," Legal Intelligencer, October 13, 2006, available at www.law.com [Hockeimer].
[61] *Hockeimer*, above.
[62] See *Rules*, above, Commentary to Rule 2.01(1).

> In many countries – including the vast majority in the European Union – in-house counsel don't have the right to claim solicitor-client privilege. The privilege rests with the outside counsel. As general counsel, they are not eligible to be members of the bar.[63]

In-house counsel in North America are charting a different course, one that leads to greater risks, and quite possibly greater rewards. It is only logical that in the evolution of the role of in-house counsel, increases in influence and prestige are being matched by increases in responsibility and assumption of risk. Successful in-house counsel will resist the natural urge to bring their feet together, but will foster an understanding within themselves and their organization about the different roles they perform, and will keep a sharp eye on the boundaries between those roles.

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[63] *Rubin*, above.

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