



Sleeping Through The Night: Tips to In-House Counsel to Avoid Personal Liability

Written by:
Patricia Brown Holmes
pholmes@schiffhardin.com
312.258.5722

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SCHIFF HARDIN LLP

6600 Sears Tower
Chicago, IL 60606
t 312.258.5500
f 312.258.5600

1666 K Street, N.W.
Suite 300
Washington, DC 20006
t 202.778.6400
f 202.778.6460

623 Fifth Avenue
28th Floor
New York, NY 10022
t 212.753.5000
f 212.753.5044

One Atlantic Center
Suite 2300
1201 West Peachtree
Atlanta, GA 30309
t 404.806.3800
f 404.806.3801

One Westminster Place
Suite 200
Lake Forest, IL 60045
t 847.295.9200
f 847.295.7810

One Market
Spear Street Tower
Thirty-Second Floor
San Francisco, CA 94105
t 415.901.8700
f 415.901.8701

www.schiffhardin.com

Introduction

In this post-Enron and WorldCom era, In-House Counsel join other corporate players — from accountants to sales forecasters to CFOs — in having actions taken in their corporate capacities more closely scrutinized and having greater exposure to criminal, civil, and professional sanctions. In several important respects, the risks and exposure faced by In-House Counsel are substantially greater than those faced by other actors within companies. While In-House Counsel must be aware of the new and heightened risks that they face, In-House Attorneys must also realize that the response to these risks cannot be to develop a “siege” or “us against them” mentality. Rather, the response must be to remain aware of the pitfalls, carry out their duties to the fullest extent possible and to the best of their ability, and to realize that the only “us” are those within the corporation that are diligent and unwavering in complying with all applicable ethical and legal standards, and that “them” are those who fail to do so. Having said this, what are some of the major compliance pitfalls faced by In-House Counsel, and how can these pitfalls be avoided and risks minimized?

I. Directors and Officers Liability Insurance

Increasingly, In-House Attorneys are being named as defendants in lawsuits filed by shareholders and other parties, including the government. While corporations typically maintain Directors and Officers liability insurance (“D&O insurance”), these policies often do not cover the General Counsel and rarely cover less senior attorneys. Thus, In-House Attorneys are often left to pay legal expenses, fines, penalties and judgments without relief of indemnification under the Company’s insurance policy. In fact, a corporation’s promise of support to culpable employees, such as the advancing of attorneys fees, through retaining the employees without sanction for their misconduct or through providing information to the employees about the government’s investigation pursuant to a joint defense agreement, may be considered by the federal prosecutor in weighing the extent and value of a corporation’s cooperation.^{1 2} This fact may cause the

¹ Memorandum from Deputy Attorney General Larry D. Thompson to United States Attorneys, Section VI (January 20, 2003).

² Note, however, that in *United States v. Stein*, 435 F.Supp.2d 330, 381-82 (S.D.N.Y. 2006), the Court held that by considering whether KPMG would advance attorneys’ fees to present or former employees in the determination of whether to indict KPMG, the government violated the employees’ Fifth and Sixth Amendment rights.

Company to leave In-House Counsel high and dry in the event that there is an investigation. In view of the tremendous increase in lawsuits filed against In-House Attorneys, it is advisable that General Counsels seek to have their Company include them, and appropriate members of their staff, within the definition of “insured persons” under the Company’s indemnification policy. In support of such a request, General Counsels should caution Company decision-makers that several aspects of the business will be affected if the request is ignored:

1. *Hiring.* As Companies seek to hire the best and brightest attorneys, they must consider the possibility that many of these individuals will be hesitant to join a team that will not provide them with the same indemnification that it affords its officers and directors;

2. *Extreme Behavior.* Without the “safety net” of such indemnification, In-House Counsel might become too conservative and overly cautious in the advice they provide and too “trigger happy” in deciding that a “reasonable basis” exists to believe that a reprehensible act or omission is at hand; and

3. *Good Behavior.* In-House Counsel will realize that the only impediment to indemnification when they are named in a lawsuit will be misconduct, misfeasance, or malfeasance on the part of the attorney. This fact will heighten the diligence with which the In-House Counsel strives to make certain that all of their acts are consistent with all applicable regulations, rules, policies, and laws.

II. Issue-Reporting Escalation

In-House Counsel should practice and encourage “issue-reporting escalation” as a matter of routine. Under such a practice, In-House Counsel encourage their non-lawyer colleagues to join them in seeking a “second opinion” regarding day to day matters with which they have concerns or disagreements.

The 307 Rules,³ as well as similar state and local rules, require that In-House Counsel report any discovery of “credible evidence of a material violation” up the ladder within the Company. As a practical matter, these

³ Section 307 of the Sarbanes Oxley Act required the SEC to “issue rules, in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers.”

requirements can leave In-House Counsel in the very uncomfortable position of having to report to a corporate officer or superior that he believes that a fellow attorney, supervisor, or an officer or executive has, or is, engaging in inappropriate conduct. Even with the “whistleblower” protections of Sarbanes-Oxley and similar laws, In-House Counsel, especially those who are relatively junior, will loath making such a report. While most attorneys will fulfill their ethical and legal obligations to make appropriate reports, the goal should be to avoid the need to make such a report. This can often be accomplished when the members of the law department routinely engage in the practice of non-confrontational and non-accusatory discussion.⁴ In-House Counsel should not reserve the use of such practice for potentially “reportable” matters. Rather, the practice should be used when, for example, the attorney and management disagree as to whether a discharge, hiring, or promotion decision creates undue exposure under Title VII. If all disagreements are communicated up the chain of command as a matter of routine in a non-accusatory and non-confrontational manner, all parties will feel more comfortable when the In-House Counsel requests that a potentially reportable matter be escalated for a second opinion. Quite simply, effective use of this practice will:

1. Deter *intentional* inappropriate acts and omissions as employees will reevaluate the appropriateness of their contemplated behavior; and

2. Lesson the likelihood of unintentional inappropriate acts and omissions, as employees, realizing that their conduct might be scrutinized by a more senior employee of the Company, will become more conscious in their decisions and more willing to seek a second opinion before a final decision is made.

III. Do Not Wimp Out

In-House Counsel should be willing to speak up when they learn of impropriety — especially if it is early enough to correct the actions of the Corporation. It is always easier to prevent a fire, as opposed to having to put one out. In-House Counsel do not have the luxury of feigning ignorance when the house of cards are about to fall. While one may be able to avoid criminal prosecution, the silently agreeing lawyer is just as morally culpable as the actors

themselves and may be subject to malpractice claims. In fact, there are certainly shrewd executives, that when facing an indictment, will turn the attention to their In-House Counsel, pointing to their silence as an indication that the conduct was legal.

Moreover, General Counsels cannot be afraid to be perceived as deal-breakers. In-House Attorneys are often consulted regarding potential corporate transactions. If a General Counsel takes issue with the legality of a transaction, implications of a transaction, or surrounding circumstances of a transaction, she must bring this to the attention of appropriate individuals within the Company. That is why they are there — to ensure adequate compliance. It is true — deal-breakers may not be invited to the infamous golf outings that the CFO is known for, but they will ultimately come out on top because of their demonstrated commitment to the Company’s well-being. A helpful note — in advising against a deal, a General Counsel should articulate to the officers and directors why the deal “smells funny” and offer creative, legal alternatives to accomplish the same goal. This can only happen when there is a strong enough rapport with upper management to allow them to trust the General Counsel’s legal knowledge and business instinct. Although breaking a deal may certainly affect one’s short-term popularity in the board room, it will show the officers and directors that they can trust their General Counsel to speak up when there is any hint of impropriety and cause them to come to that General Counsel when making other important decisions.

IV. Refuse to “Sign Off”

The policies of most companies require that In-House Counsel review and provide their approval via signature on most matters having legal ramifications or significant business implications. Very often, the “sign off” by In-House Counsel occurs just prior to “sign off” by the most senior corporate officer. Typically, that individual will not “sign off” unless someone from the legal department has done so. In-House Counsel should withhold signature-approval of any matter that he or she believes to be inappropriate or questionable. Counsel should never provide signature-approval with “disclaimer” that, “I’ll sign, but I am really not comfortable with this.” Quite obviously, prudent In-House Counsel should never sign off based upon the assurances of another person (especially not someone with a vested interest in the matter). In-House Attorneys should never trust the phrase, “Don’t worry, I’ll tell the VP that you have concerns with this.” As described above, counsel should offer to participate in a non-

⁴ Scott Harshbarger & John Hanson, *New Realities of Corporate Governance For In-House Counsel*, New England In-House (2004) (<http://www.newenglandinhouse.com/200404issue/Harshbarger.htm>.)

confrontational, non-accusatory discussion with the advocates of the matter and upper management to express her concerns and to resolve any disagreement regarding the matter. Objections, issues and concerns should be reduced to an appropriately crafted writing and forwarded, at a minimum, to the attorney's immediate supervisor. In-House Counsel's withholding of "sign off" also significantly lessens the likelihood that she will be named as a defendant, or when named, found to be liable.

V. Remember Who the Client Is

In recent years, members of corporate departments, such as the human resources department and the legal department have been encouraged to become "strategic partners" with revenue-producing functions within the business. In an effort to accomplish this goal, In-House Counsel may be expected to seek and establish close professional and personal relationships with their colleagues within the organization on the "business side." While it is natural, and even beneficial, that In-House Counsel develop a strong sense of loyalty to these individuals, and a strong desire to see them succeed, counsel must not lose sight of the fact that it is the Company that is her client.⁵ Accordingly, her loyalty and obligations must be to the Company first and foremost.

By earning the respect and trust of her business-side colleagues, In-House Counsel can be exceptionally effective in guiding these colleagues away from inappropriate acts or omissions. When, however, such guidance and persuasion is not effective, counsel must resort to the appropriate outside reporting measures. As important as it is for counsel to remember that her client is the Company, and not any individual within the Company, it is just as important that those to whom counsel gives advice and counsel on a day to day basis to be reminded that ultimately the Company's well-being is her foremost concern. In addition to giving added weight to the advice rendered by counsel, such knowledge will detract from anyone's request or expectation that In-House Counsel will do anything that will compromise her loyalty and obligation to her client.

VI. The Many Hats of the In-House Counsel

From day to day, from meeting to meeting, from comment to comment — in-house lawyers must know which hat they are wearing. Obviously, one of the most important goals of

In-House Counsel should be to win the trust and confidence of those to whom he or she provides day to day advice and counsel. One can be assured that this goal is accomplished when the employees on the business side begin to solicit the In-House Counsel's advice and opinion regarding matters that are more business in nature than they are legal. When this happens, In-House Counsel should enjoy the vote of confidence, but must also be careful. First, to the extent that the Company has included In-House Counsel in its D&O coverage, it may have included him or her solely in his or her capacity as an attorney providing *legal advice, not business advice*. As a result, to the extent that General Counsels are ever sued based, in whole or part, upon their "business advice," they may not be covered. To determine whether In-House Counsel's conduct is within the scope of "legal advice" for the purpose of D&O insurance protection, she must understand the definition of "professional services" as provided in her Company's insurance policy. Some insurance companies will deny coverage based on the uncertainty or hybrid-nature of the action at issue. So how does an In-House Counsel differentiate between the two, and more importantly, how does she help her Company distinguish the two? Typically, legal advice means advice or an opinion on a matter of law as it applies to the entity. Business advice, on the other hand, is provided with little or no consideration of the legal ramifications of the decision and resemble something normally handled by corporate managers or executives. To minimize the inevitable blurring of the line between the two, an In-House Counsel must make it clear that she is rendering legal advice, and not business advice. This distinction is particularly important in relation to written client communications.

Second, a General Counsel should be aware that the assertion of attorney-client privilege is often an uphill battle, even under the best of circumstances. That is because not every communication with the General Counsel is protected under this privilege. Some of the first questions that will be asked when In-House Counsel attempts to assert the privilege on behalf of a corporate client is: who exactly in the organization can assert the privilege, who can waive the privilege (employees, officers, directors), and in what context was the allegedly privileged advice given? Keep in mind—any statements or acts by counsel that are more business in nature than legal, may totally destroy the Company's ability to effectively assert the privilege.

Furthermore, In-House Counsel can potentially avoid liability by retaining outside counsel for advice. Outside law firms have the resources necessary to help Companies

⁵ ABA Model Rule of Professional Conduct 1.13(a).

avoid pitfalls and, as a result of scandals like Tyco and WorldCom, have developed unique skill sets in order to more effectively serve their corporate clients. If a General Counsel has doubts about a pending decision, potential issue, or course of action, he or she would be well served to retain outside counsel to get a second legal opinion. Outside counsel has little incentive to approve or participate in the unlawful conduct of a client. Accordingly, reliance upon a private law firm may effectively protect In-House Counsel from potential criminal or civil liability.

Conclusion

The risks and exposure faced by In-House Counsel are substantially greater than those faced by attorneys in private practice. Indeed, In-House Attorneys are charged with the task of providing effective legal counsel and ensuring compliance to the law, but In-House lawyers face the additional (and sometimes daunting) task of doing so in a setting in which the “business” of the corporation is intrinsically intertwined with the legal task at hand. In an increasingly hybrid corporate environment, however, In-House Attorneys must resist the pressures to succumb to the “business” of the corporation. In-House Counsel must remember their roles as attorneys. The same precautions that a General Counsel takes to minimize his or her exposure are actions that the Company’s executives, officers, and directors have hired him or her to take as a means of helping *them* to avoid or minimize catastrophic events in the future. In providing effective legal counsel to officers, directors, and employees, General Counsels not only protect themselves from liability, they protect the corporation as well — and that will help everyone sleep like a baby!

About the Author

Patricia Brown Holmes is an Equity Partner in Schiff Hardin LLP. She is a former state trial judge who concentrates her practice in general commercial litigation and white collar criminal and corporate compliance matters. Schiff Hardin LLP Associates **Drahcir Smith** and **Marla Shade Harris** are credited for their contributions to this article.

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