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Canadian Centre for Ethics and Corporate Policy

"How do Ethical Standards Apply to In-House Counsel?"

GOOD AFTERNOON:

When I was asked to do a talk at this luncheon on the subject of Ethics and In-House Counsel, I just assumed that a great deal of writing and research would have been done on the subject of ethics in the legal profession. I was somewhat astounded to discover that, at least in Canada, there has been very little academic research done on the subject of legal ethics. I could find only two books on the subject both relatively recent and one of the authors Allan Hutchinson had lamented as late as 1998 about the lack of Canadian scholarship in the field of legal ethics:

- Allan Hutchinson's "*Legal Ethics and Professional Responsibility*" published in 1999;
- Gavin MacKenzie's loose-leaf "*Lawyers and Ethics*" published in 1993.

A number of legal articles appeared after the Supreme Court of Canada's decision in Martin v. Gray [1990] 3 SCR 1235 in which the standard to be applied in determining what constitutes a disqualifying conflict of interest was addressed. The majority held that where it is shown by the client that a previous relationship existed sufficiently related to the retainer from which disqualification is sought then it should be inferred that previous confidential information was imparted. The case and the ensuing academic discussion dealt almost exclusively with ethics as between lawyers.

There has been almost no examination in either Canada or the United States of the role of the in-house lawyer. The only in-depth research study of in-house counsel was done by one of your directors Sally Gunz, with her brother Hugh Gunz in the late 1980's. I could find no comparable research in U.S. legal literature, and in fact a number of U.S. legal scholars have remarked on this fact. Sally has written an excellent book "*The New Corporate Counsel*" but I think she would agree it is really a "how to" book. How to become a corporate counsel and how to develop and run an in-house legal department.

In an article in 1994 the Gunz¹ discussed how ethical issues within corporations and their managements have gained prominence in the whole deluge of articles and discussions about Corporate Governance, which grew out of the corporate scandals of the late 1980's and early 1990's. Ethics are very much a part of good Corporate Governance yet the two subjects are usually looked at separately. Unfortunately, it would appear that the incorporation of ethics as an integral part of Corporate Governance, particularly in the Investment Banking

¹ "Ethical Implications of the Employment Relationship for Professional Lawyers" HP & SP Gunz UBC Law Review (1994) 28 UBC L.R. 123

Community has still a long way to go if one looks at the recent OSC investigations into RT Capital Management and Yorkton Securities, and the whole Enron scandal in the United States. I haven't for the purposes of this paper discussed the Enron scandal because it is still unravelling. But I would make two comments. Assuming Enron had a General Counsel, where was this person and secondly, the tightened regulatory fall-out will be felt for a long time.

The little discussion that has revolved around professionals employed in corporations has viewed their role in terms of moral leadership. This leadership derives from two factors – the first being that professionals must undertake training in applying ethical standards to decision-making (I personally would question how realistic is this statement. Law schools don't teach ethics in their standard curriculum and the training in Bar Admission Courses is at best rudimentary). The second factor is that employed professionals are typically obliged to maintain a certain independence from the politics and operations of the corporation because they are required to comply with the ethical obligations of their profession.

Let me turn to the specifics of acting as an in-house counsel and the multiplicity of ethical standards that apply. The counsel has a whole collection of competing and very often conflicting duties and in-house loyalties. In my view, these are usually more than those affecting the private practitioner corporate lawyer. He has duties and loyalties:

1. To the legal profession under the applicable Rules of Practice;
2. To the corporation – where today most large corporations have Codes of Conduct often administered by their Compliance Group.
3. If it is a regulated industry then to the specific Regulator and the Regulations and Guidelines it has put in place.
4. If it is a publicly listed company then to the Securities Regulators in Canada and the relevant stock exchanges.
5. If it is interlisted in the United States then to the Securities and Exchange Commission and the relevant stock exchange.
6. If the corporation is carrying on business internationally the list will only grow longer.

One writer described the situation as follows:

"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 business²."

² Timothy P. Terrell Professor of Law Emory University School of Law 1977 Emory Law Journal The Randolph Thrower Symposium: *The Role of the General Counsel*.

Who Is The Client?

For the Corporate Counsel "Who is the Client?" is a major question. The corporate counsel owes allegiance to the corporation and it is the client, unlike the private practitioner in a law firm whose loyalty and allegiance is not to the law firm but rather to the clients that make up the lawyer's practice. The corporate counsel does not represent the constituent parts of the corporation such as its directors, officers or employees and this is a very important distinction. An in-house counsel will carry out duties for, and be instructed by agents of the corporation but if any conflict arises with these agents it is the rules of the corporation that prevail. If the in-house lawyer tries to represent both the corporation and an employee personally it is almost a certainty that a conflict of interest will arise. The other more practical reason is that the in-house lawyer as an employee is not required to carry negligence insurance but if he acts for the employee in a private capacity he is required to do so and the cost will come out of his own pocket. The corporate counsel may represent subsidiary companies of the parent organization but a conflict of interest may potentially arise if such representation is carried over to affiliated companies with less than majority ownership and the requirement to carry negligence insurance would also arise.

Professional Rules

Having established who is the client for the in-house lawyer what are the rules of conduct that govern? Well, basically not very many. I am not going to spend time today setting out the few rules that are in the *Law Society of Upper Canada's Rules* (2000), but if any of you are interested I do have them.³

I do want to set out one rule because it has important ramifications in relation to "whistle blowing" which I will refer to later.

Rule 2.03(i) Confidential Information

"A lawyer at all times shall hold in strict confidence all information concerning the business and affairs of the client acquired in the course of the professional relationship and

³ Rule 2.01(1) Competence

"Competent lawyer" means a lawyer who has and applies relevant skills, attributes, and values in a manner appropriate to each matter undertaken on behalf of a client including ."

Commentary

"In addition to the opinions on legal questions, the lawyer may be asked for or expected to give advice on non-legal matters such as business, policy or social implications involved in a question or the course of action that the client should choose. The lawyer who advises on such matters should, where and to the extent necessary point out the lawyer's lack of experience or other qualification in the particular field and should clearly distinguish legal advice from such other advice."

shall not divulge any such information unless expressly or impliedly authorized by the client or required by law to do so.

Commentary

"A lawyer employed or retained to act for an organization, including a corporation, confronts a difficult problem about confidentiality when he or she becomes aware that the organization may commit a dishonest, fraudulent, criminal or illegal act. This problem is sometimes described as the problem of whether the lawyer should "blow the whistle" on his or her employer or client. Although the Rules of Professional Conduct make it clear that the lawyer shall not knowingly assist or encourage any dishonesty, fraud, crime or illegal conduct Rule 2.02(5), it does not follow that the lawyer should disclose to the appropriate authorities an employer's or client's proposed misconduct. Rather, the general rule, as set out is that the lawyer shall hold the client's information in strict confidence and this general rule is subject to only a few exceptions (these are primarily where there is a criminal offence that is likely to be committed).

Assuming the exceptions do not apply there are steps that a lawyer should take when confronted with the problem of proposed misconduct by an organization.

The lawyer should recognize that his or her duties are owed to the organization, and not to the officers, employees or agents of the organization. The lawyer should ask that the matter be reconsidered, if this fails it may be appropriate for the lawyer to resign."

The Code of Professional Conduct of the Canadian Bar Association – the commentary to some of its Rules at least refers to the position of in-house counsel but they aren't much better⁴.

⁴ Chapter III

Rule: The lawyer must be both honest and candid when advising clients.

(much the same as Rule 2.01(1) of the Law Society)

Commentary

#10 Advice on Non-Legal Matters:

"In addition to opinions on legal questions, the lawyer may be asked for or expected to give advice on non-legal matters such as the business, policy or social implications involved in a question, or the course the client should choose. The lawyer who advises on such matters should, where and to the extent necessary point out the lawyer's lack of experience or other qualification in the particular field and should clearly distinguish legal advice from such other advice."

Chapter IV.- Confidential Information

Rule: "The lawyer has a duty to hold in strict confidence all information concerning the business and affairs of

As far as I can ascertain, there are no Professional Rules in Canada that recognize the differential between in-house and outside counsel. I and Bob Jones, then Executive Director of the Canadian Corporate Counsel Association appeared before a Committee of the Law Society then examining the Rules of Conduct, with a view to having at least some Rules included to assist in-house counsel in governing the multitude of roles that they are asked to undertake. There was absolutely no interest by the Benchers nor has there been any interest by the Canadian Bar Association. I suppose I would be accused of extreme cynicism were I to suggest the reason is that in-house counsel employ many of the Law Society and CBA members and there is no desire to upset in-house counsel. Frankly, I don't even think it is as reasonable as that. I think it is just a total lack of interest or understanding by the profession about in-house counsel and any legal and ethical problems they may have. However, in the United States the ABA Model Rules do recognize this distinction and I will refer to them later in greater detail.

the client, acquired in the course of the professional relationship and the lawyer should not divulge any such information unless expressly or impliedly authorized by the client, required by law or otherwise permitted or required by this Code."

Commentary

11 then provides clarification noting that disclosure of information will be justified if the lawyer has reasonable grounds for believing that a crime is likely to be committed and will be mandatory when the anticipated crime is one involving violence and disclosure is necessary to prevent the crime taking place.

Chapter V: Impartiality and Conflict of Interest

Rule: "The lawyer shall not advise or represent both sides of a dispute and, save after adequate disclosure to and with the consent of the clients or prospective clients concerned, shall not act or continue to act in a manner when there is or likely to be a conflicting interest."

Commentary

#12. "A lawyer who is employed or retained by an organization represents that organization through its duly authorized constituents. In dealing with the organization's directors, officers, employees or shareholders the lawyer shall make clear that it is the organization that is the client when it becomes apparent that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing. The lawyer representing an organization may also represent any of the directors, officers, employees, shareholders or other constituents, subject to the provisions of this Rule dealing with conflicts of interest."

I would now like to raise a number of issues which are particular to in-house counsel and all of which have ethical implications:

1. The In-House's Lawyer's Client

It is clear that the client is the organization but this fact in itself raises many practical problems for the in-house lawyer. The organization is an inanimate object and only has such rules, regulations and codes as are ascribed to it by its constituents. The corporate counsel must consider major ethical issues within the corporation:

- The duty of loyalty to the client;
- Conflicts of interest;
- The obligation to maintain solicitor-client privilege; and
- The need for reasonable diligence when acting on behalf of the client.

All of these ethical issues are directed at the organization as the client but how does the in-house counsel deal with the fact that individual constituents of the client have actually hired him, and can certainly fire him. Furthermore, these are the individuals that give him his instructions. There is almost an inevitable divergence between the goals of these individuals and what the in-house counsel may see as the best interests of the corporation. Very often senior management in particular has difficulty in understanding that the corporate counsel represents the interests of the company and not their interests. The only legal advice a corporate counsel can give to an individual is to assist in retaining outside counsel to represent him.

Too Many Titles

General Counsel in a corporation if they have any ability will become involved in the business as well as the legal aspects. In fact, one of the major reasons that lawyers go in-house is so they can be closer to the business decisions and also have the opportunity to move out of the legal function and into a strictly business function, General Counsel are usually officers of the corporation and very often they also act as the Corporate Secretary giving them access to and involvement with the Board of Directors. In financial institutions, and certainly it was true in CIBC, the General Counsel has responsibility for Compliance with the Compliance Officer reporting to him, which adds a whole new level of ethical problems to his position.

All of the above roles are difficult and have potential pitfalls, for where does the legal role end and the business role commence? However, the risk factor also rises precipitously when the General Counsel sits on the Board of Directors:

- i) How can he be a member of the Board and yet retain his independence when advising it on legal matters?
- ii) What is his position if there is a conflict between the Board and the Corporation keeping in mind he owes his loyalty to the company as his client and not to the other Directors?
- iii) If faced with a severe conflict the General Counsel can resign from the Board, but such a resignation could have a severe public relations fall-out.

The more titles that a corporate counsel carries in an organization the more likely that conflicts will arise.

How Does the Hierarchical Composition of In-House Legal Department affect the Need for Independence?

The in-house lawyer is part of the hierarchy within the Corporation that starts with the Board of Directors and descends down through the CEO and the individual business and administrative heads of which the General Counsel is one. This then raises the question of the corporate counsel's independence.

Is corporate counsel or outside counsel more likely to have the independence to tell senior management or the board of directors what they may not want to hear? Both lawyers are in the first instance officers of the court and bound by their Rules of Conduct to maintain their independence.

The Model Rules of Conduct of the ABA in the United States have recognized the conflict between the hierarchy of the organization and the need for independence by in-house counsel. The Rules require a lawyer who has direct supervisory authority over another lawyer whether in a law department or law firm to make reasonable efforts to ensure that the junior lawyer conforms to the Rules of Professional Conduct, including that of independence. The American Rules impose an obligation on a supervising lawyer of direct personal responsibility for ethical compliance by junior lawyers, over whom the supervising lawyer has authority, with the Rules of Conduct. Finally, the American Rules require a subordinate lawyer to fulfill his duties as a lawyer, even in the case of contrary instructions by a supervisor. We have nothing in the Canadian Rules of Conduct even closely approximating these Rules.

How does the corporate counsel deal with a major problem where he knows that an officer, employee or other person associated with the corporation is engaged in an action that is a violation of a legal obligation of the corporation? The American Model Rules set out a course of action in this situation. The corporate counsel must give due consideration to the seriousness of the violation, the potential consequences, the scope and nature of how he can represent the situation, and the level of responsibility of the perpetrator in the organization. The action to be taken must minimize disruption to the organization while bringing settlement to the situation. Such action may include:

- (i) Asking for reconsideration of the matter by the employee or officer involved;
- (ii) Escalating the matter to the appropriately responsible officer;
- (iii) If necessary advising that an outside legal opinion be sought to present to the appropriate authority in the organization.

I was very fortunate in CIBC because Don Fullerton, the Chairman from 1984 to 1992 had the Board of Directors pass three identical resolutions applicable to three separate officers in the Bank, the Chief Compliance Officer/the Chief Internal Auditor and the General Counsel. The resolution set out very clearly the responsibility of these officers, if any of them came across a problem which would impugn the legal or ethical obligations of the Bank. Such officer was required to follow this course of action:

- (i) require the officer in charge of the business area where the problem originated to consider or reconsider the matter;
- (ii) if there was no resolution of the problem then the matter had to be escalated to the Chairman and Chief Executive Officer;
- (iii) if there was still no resolution of the problem then the matter had to be escalated to the independent director chairman of the Audit Committee of the Board of Directors.

I am not sure what would happen at that point because I never got past just threatening to implement step one. I doubt many other corporations have as clear an action plan as this but it certainly gave me support in maintaining my independence as General Counsel.

There may be instances where a conflict arises between the corporate counsel and officers of the corporation and the best course of action is to turn the matter over to outside counsel rather than the inside counsel inadvertently landing himself in a situation where he is caught between acting on behalf of the corporation proper and appearing to act on behalf of its officer and/or directors.

The Corporate Counsel And Their Employer Client

One of the most difficult ethical problems for the corporate counsel is the dual role of acting as lawyer for, and yet being an employee of, the organization. The unique role has been judicially defined in an American Case General Dynamics Corp. v. Superior Court 876 P2d 487 (Cal. 1944) where The California Supreme Court observed:

"In-house counsel are also employees of the corporation and as such are subject to the human resources policies."

There is always the possibility of a personal employee-related dispute between the corporate counsel and the employee particularly if the situation has deteriorated to the point of termination. If the corporate counsel then brings a wrongful dismissal suit against the corporation his former client, is there then an ethical issue of his breaching the duty of loyalty to his ex-client? What happens to the duty of confidentiality when the corporate counsel has as a result of his position in the corporate hierarchy, been privy to a great deal of confidential information? Can he use confidential information which would help his case but be detrimental to the corporation and by doing so does he breach his ethical responsibility under the Rules of Practice?

The *American Corporate Counsel Association* (ACCA) has taken the view that the duty of loyalty owed by any lawyer to his client precludes an in-house lawyer from suing his employer-client. However, such a view seems to fly in the face of natural justice and the right of an individual to seek redress from the court for a legal wrong. ACCA states that to take legal action the in-house counsel would have to resign from his position. In reality if the relationship has deteriorated to such an extent that the in-house lawyer is contemplating litigation he should probably resign in any case.

Ethical Challenges facing Corporate Counsel in a Global Corporation.

The globalization of business and capital markets is presenting General Counsel with a whole new series of unique challenges:

Firstly, they must devise new management techniques to cover the operation of a multitude of offices for the legal department some of them in foreign countries. Secondly, they have to integrate lawyers from different legal systems into a single legal department; and thirdly, they have to oversee the delivery of legal services to the corporation in one or more foreign countries.

Furthermore, in addition to the above challenges the General Counsel of a Global Corporation is faced with an additional series of ethical challenges. The Rules of Practice (if any) and the legal Code of Conduct (if any) will certainly, if the foreign operations are in the Third World, not have the level of importance that they do in North America and Europe. The General Counsel is also faced, when retaining law firms, in Eastern Europe, Russia, China and most parts of the Third World with the fact that the legal profession is in a very embryonic state. The General Counsel will have to do a great deal of legal shepherding in order to manage a matter to fruition in such areas.

However, one area that the General Counsel of a Global organization will find very frustrating is that of Conflicts of Interest. One American writer ⁵ described the situation as follows:

"In most civil law countries conflicts are a matter of personal ethics not law. Conflicts are a matter of your relationship with your client. In common law countries conflicts of interest are very often a matter of law."

The absence of a common well-established definition for a conflict of interest and of jurisprudence to support the same hinders the General Counsel in a number of ways:

1. it makes timely detection of conflicts of interest within the foreign offices more difficult to detect and pinpoint;
2. the General Counsel may never learn of the conflict but it can still erupt publicly in the home country.
3. the corporation as a client in the foreign jurisdiction may not have access to a judicial remedy or disciplinary sanction to protect against conflict-free external legal representation.
4. any complaint filed by the General Counsel of a Global Corporation against a local law firm could have serious political repercussions that could damage the right of the corporation to carry on business in the jurisdiction.

⁵ Mary Daly, Professor of Law Fordham University School of Law: Paper presented The Randolph Thrower Symposium at Emory School of Law 1997.

Moonlighting

The rarity of cases in which in-house counsel have been disciplined for professional misconduct would suggest that the fear of compromised independence and conflicts is illusory. I would set out a more cynical response and point out that since inside counsel are not dealing with a client's funds, they are not subject to the temptation of dipping into such funds. Furthermore, if an employed lawyer breaches his employer's guidelines or the rules of professional conduct, it is highly unlikely that the employer will report the matter to the appropriate Law Society. The employer will want as little publicity as possible, since any such action could cause a negative reaction to the employer for having let such a person slip through the employment screening process. It will be a discreet termination with no attempt to prove cause unless the circumstances are so blatant as to be unassailable.

However, moonlighting is one of the few areas where professional misconduct issues are apt to arise. The question is whether a corporate counsel can do legal work for clients other than their employer. Firstly, if the corporate counsel does so he becomes the same as any other lawyer carrying on a private practice and therefore must carry negligence insurance. Secondly, it is almost guaranteed that if a corporate counsel does legal work for other employees, that a conflict of interest will arise. Thirdly, if they do legal work for other clients, the time spent on this work, or at least some of it, will come out of the time they are supposed to be working for their employer and for which they are being paid, which in itself is a conflict of interest situation. Fourthly, and probably most important it will be in doing work for such clients that problems may arise could cause complaints to be made to the Law Society.

Whistle Blowing

This area is one of the most controversial of all in the realm of legal ethics and reams of paper have been used in articles on the subject and it is particularly applicable to corporate counsel.

The lawyer is bound by the Professional Rules and as an Officer of the Court to uphold the law. However, on the other hand, he has a duty not to betray the trust of his client.

The in-house lawyer has a duty to the corporation to take measures to prevent any employees from causing it harm. However, the problem that may very well arise is that if a situation arises, which may, if not resolved cause harm to the organization and it could be economic or even publicity harm, and if the corporate counsel does not report it to the appropriate level of authority either in or outside the corporation, then if the matter subsequently becomes public the in-house lawyer will probably be held culpable along with other executives. The forced resignation in 1991 of Donald Feuerstein, the General Counsel of *Solomon Brothers Inc.* in New York by the SEC was for not blowing the whistle on a U.S. Treasury bond fraud. The case clearly brought the whole dilemma of "whistle blowing" by in-house counsel into the spotlight. However, "whistle-blowing" is in direct conflict with a lawyer's requirement to keep the actions of his client confidential.

Also, to be blunt, I know of no case where a whistle-blower in any profession or job has received any praise. Usually, no matter how right they may be. They are vilified, often fired and are blackballed by society. Frankly, I think this attitude says a lot as to where our

North American corporate society really stands when the breach of rules, standards and ethics come into play.

Confidentiality

Allen Hutchison in his book "*Legal Ethics and Professional Responsibility*" P.170 in discussing the position of in-house counsel states:

"The customary justification for confidentiality does not apply to the realities of corporations. Companies involve their in-house lawyers in business matters and in the decision-making process, that is why they employ them. A corporation doesn't need to protect its economic reputation – the need for confidentiality is less compelling."

I am not sure that I would totally agree with this statement corporations may have very strong competitive reasons for wanting to protect confidentiality. The problem for in-house counsel is how far can they protect confidentiality. In both the U.S. and Canada the courts have tended to give solicitor- client privilege a fairly broad ambit when looking at the position of in-house counsel.

To date Canadian Courts have extended the privilege to in-house counsel provided the material has been created as a legal communication or document, and has been held in a reasonably confidential manner in the Legal Department without copies floating around the company.

Re: Shell Canada Ltd. [1975] F.C.J. 184

(Director of Investigations and Research) (Combines)

The Director entered onto the premises of Shell Canada under section 10(r) of (the then in-force) *Combines Act* with a view to seizing evidence. The General Counsel of Shell refused access claiming solicitor-client privilege. The Federal Court stated that the powers conferred on the Director did not undermine the solicitor –client relationship of confidentiality and therefore the principle of solicitor-client privilege also applied to in-house counsel.

However, if in-house counsel steps outside their role as lawyers and act as businessmen or in some capacity other than that of lawyer, privilege will not apply. Often, the dividing line between giving legal advice and contributing to a business decision is crossed by in-house counsel without his being even aware.

A good example of the dilemma was one I faced myself in the CIBC. As part of my responsibilities, in addition to being General Counsel I sat on the Management Committee of the Bank and acted as Secretary of the Committee. The question was whether I was on the Committee in a legal capacity, or because I was head of Corporate Governance with responsibility for the Legal, Compliance, Corporate Secretary and Internal Audit or in a purely business capacity or a combination of all three. Clearly, the Bank's chairman wanted me on the Committee in a legal capacity to ensure that all discussions and decisions could be supported from a legal viewpoint. However, I am not at all sure that I would like to have tested whether solicitor-client privilege would have attached to my role.

Can a corporate counsel whistle blow and yet keep the workings of the corporation confidential? The obvious answer is no, so if you whistle blow you breach this ethical requirement and if you don't you breach the ethical standard of knowing the corporation is condoning wrongdoing.

Summary

I am, in the interests of time, going to end at this point. I have tried in a very quick and probably in far too shallow a fashion to give you a sketch of how ethical standards affect in-house counsel and why I think their role is an extremely complex and demanding one, and I have certainly raised far more questions than I have given answers. What is particularly unfortunate is that none of the Canadian legal regulators have shown any interest in assisting in-house counsel by promulgating useful and pragmatic Rules of Practice. There just wasn't the time to more than allude to the fact that in addition to what I have set out, in-house counsel are today very involved in the whole issue of compliance and the inter-relationship with outside regulators, but perhaps that can be a subject for a future luncheon talk.

THANK YOU