

In-house counsel as guardian of brand equity



**BRAND
EQUITY**

The introduction of the *Sarbanes-Oxley Act* in 2002 by the U.S. government, against the backdrop of the financial scandals that rocked companies like Enron, WorldCom and Adelphia, reverberated throughout the worldwide legal community.

Questions were raised then about the duty of confidentiality to the client and blowing the whistle on improper corporate conduct, and perhaps most importantly, about the independence of counsel, particularly in-house counsel. In response, the Law Society worked with members of the profession and the OSC to develop amendments to the *Rules of Professional Conduct* which strongly supported both solicitor-client privilege and lawyer independence, and gave clear guidance to in-house counsel facing ethical challenges like illegal corporate conduct. These were introduced in March 2004 (see *Relevant Rules of Professional Conduct* overleaf).

A test of the independence of in-house counsel may occur during the current recession, when corporate executives might be tempted to cut corners in an effort to stave off losses and perhaps the very collapse of their companies. Not only may the pressures from above be greater during a recession, but the perils of resistance could be severe for in-house counsel, who would be putting their livelihood on the line when alternative employment is least available.

Recent interviews with senior in-house counsel suggest a heightened sensitivity to recessionary pressures but no infringement on their duty of independence. Typical of the respondents was **Erin O'Toole**, corporate legal counsel at Procter & Gamble Canada, the consumer goods company.

At Procter & Gamble, he says, "There are pressures in terms of trying to reduce some of our costs of outside legal counsel, but in terms of providing legal advice, I have not experienced any incidents where the economic

emphasis has changed the way we give advice.”

While in-house counsel interviewed for this article were confident that their own duty of professionalism and independence had not been eroded by the recession, they could envision that colleagues at other corporations may not be immune to economic pressure.

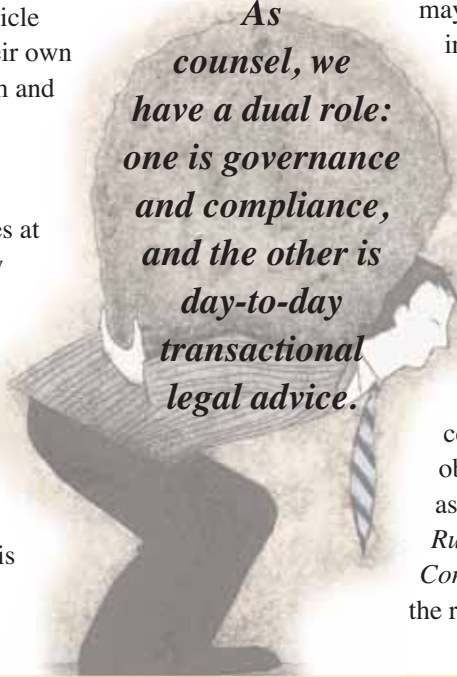
“I suppose that economic pressures might be a driver in some places, depending on what business the company is in, what sort of pressures they’re

under to survive, and what sort of potentially controversial options they might pursue that counsel may view as

inappropriate or over the line,” says **Brian Swartz**, senior vice president, legal of Aecon Group Inc., the construction and infrastructure development company. “But certainly the obligation we have as lawyers – the *Rules of Professional Conduct*, coupled with the regulatory

environment introduced with the advent of Sarbanes-Oxley in the U.S. and Bill 198 in Canada – puts a heightened awareness on counsel. It would be unfortunate if anyone felt that kind of pressure to support a position, initiative or disclosure issue which would be beyond the bounds of prudent legal advice. Certainly, it wouldn’t happen in our organization.”

Even the pressures to reduce outside legal costs can have the effect of infringing upon in-house counsel’s professionalism, says **Kathleen Flynn**, general counsel at Indigo Books & Music Inc. “I haven’t experienced this, but can foresee how counsel could be pushed to take certain positions that typically they would not be or may not be comfortable with. You may, for instance, be asked to render an



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Relevant Rules of Professional Conduct

Rule 2.02 (1) Honesty and Candour

When advising clients, a lawyer shall be honest and candid.

Rule 2.02 (1.1) When Client an Organization

[Commentary] A lawyer acting for an organization should keep in mind that the organization, as such, is the client and that a corporate client has a legal personality distinct from its shareholders, officers, directors, and employees. ... The lawyer should ensure that it is the interests of the organization that are to be served and protected.

Rule 2.02 (5.1) and (5.2) Dishonesty, Fraud, etc. when Client an Organization

These are the up-the-ladder reporting provisions. [Commentary] Rules 2.02 (5.1) and (5.2) speak of conduct that is dishonest, fraudulent, criminal or illegal, and this conduct would include acts of omission as well as acts of commission. ... Once a lawyer acting for an organization learns that the organization has acted, is acting, or intends to act in a wrongful manner, then the lawyer may advise the chief executive officer and shall advise the chief legal officer of the misconduct. If the wrongful conduct is not abandoned or stopped, then the lawyer reports the matter “up the ladder” of responsibility within the organization until the matter is dealt with

appropriately. If the organization, despite the lawyer’s advice, continues with the wrongful conduct, then the lawyer shall withdraw from acting in the particular matter in accordance with rule 2.09. In some but not all cases, withdrawal would mean resigning from his or her position or relationship with the organization and not simply withdrawing from acting in the particular matter.

These rules recognize that lawyers as the legal advisers to organizations are in a central position to encourage organizations to comply with the law and to advise that it is in the organizations’ and the public’s interest that organizations do not violate the law. Lawyers acting for organizations are often in a 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.

Rule 2.03 (1) Confidential Information

[Commentary] A lawyer cannot render effective professional service to the client unless there is full and unreserved communication between them.

opinion... on some matter that is outside your areas of expertise. I can sympathize with someone who's under pressure to do that in financially difficult times."

Whether in recessionary times or not, the key to maintaining independence is for in-house counsel to recognize that their client is the corporation as a whole, rather than the president or even the board of directors. While that principle is simple in theory, it can be complicated when an in-house lawyer wears more than one corporate hat.

"I do think it would be a challenge for those lawyers who have a dual role," says P&G's O'Toole. "In some companies, legal counsel may serve as a vice-president of legal & corporate affairs. I think that might be more

challenging because they would have a business development role as well as a legal role. Our company is large enough that I am basically paid to be a lawyer and to provide counsel to management."

The commentary to Rule 2.04 (3) deals specifically with this situation. It says, "A conflict of interest may arise when a lawyer acts not only as a legal advisor but in another role for

the client. For example, there is a dual role when a lawyer or his or her law firm acts for a public or private corporation and the lawyer serves as a director of the corporation." In these situations, "Before accepting a dual role, a lawyer should consider these factors and discuss them with the client."

Aecon's Swartz, in his role as legal counsel, has no difficulty identifying his client as the corporation as a whole. But in addition to being in-house counsel, he is also secretary to the board. "As counsel, we have a dual role: one is

How do they work collaboratively with senior management while retaining a separate and independent role?

Rule 2.03 (3) Justified or Permitted Disclosure

[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)) and provide a rule for how a lawyer should respond to conduct by an organization that was, is or may be dishonest, fraudulent, criminal, or illegal (Rules 2.02 (5.1) and (5.2)), 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 above, is that the lawyer shall hold the client's information in strict confidence, and this general rule is subject to only a few exceptions. Assuming the exceptions do not apply, there are, however, several steps that a lawyer should take when confronted with the difficult 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 (Rule 2.02 (1.1)) and the lawyer should comply with Subrules 2.02 (5.1) and (5.2), which set out the steps the lawyer should take in response to proposed, past or continuing misconduct by the organization.

Rule 2.04 (3) Avoidance of Conflict of Interest

[Commentary] A conflict of interest may arise when a lawyer acts not only as a legal advisor but in another role for the client. For example, there is a dual role when a lawyer or his or her law firm acts for a public or private corporation and the lawyer serves as a director of the corporation. Lawyers may also serve these dual roles for partnerships, trusts and other organizations. A dual role may raise a conflict of interest because it may affect the lawyer's independent judgment and fiduciary obligations in either or both roles, it may obscure legal advice from business and practical advice, it may invalidate the protection of lawyer and client privilege, and it has the potential of disqualifying the lawyer or the law firm from acting for the organization. Before accepting a dual role, a lawyer should consider these factors and discuss them with the client.

Rule 2.09 (7) Mandatory Withdrawal

Subject to the rules about criminal proceedings and the direction of the tribunal, a lawyer shall withdraw if

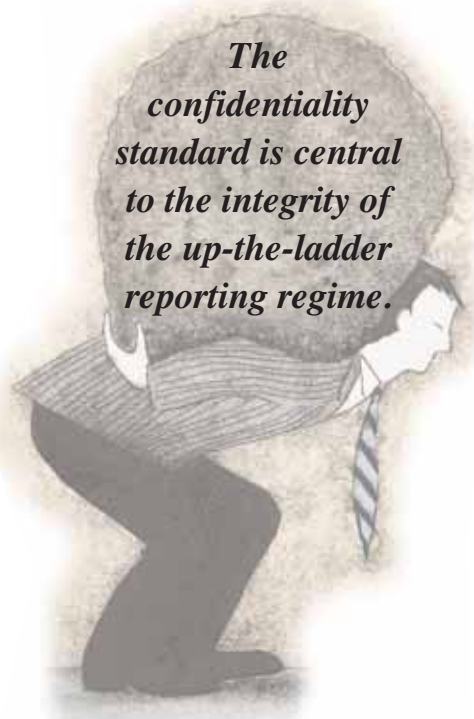
- (d) it becomes clear that the lawyer's continued employment will lead to a breach of these rules,
- (d.1) the lawyer is required to do so pursuant to Subrules 2.02 (5.1) or (5.2) (dishonesty, fraud etc. when client an organization).

governance and compliance, and the other is day-to-day transactional legal advice. At the end of the day, it's the corporation that gets the advice. If an internal client was to ask for something that pushed the envelope and tested independence, then we would push back, as proper governance and corporate compliance take precedence in protecting the overall interests of the corporation."

In the extreme, when counsel is faced with serious corporate misconduct, pushing back could mean in-house counsel reporting "up the ladder" within the organization. The amendments adopted in March 2004 included Rules 2.02 (5.1) and (5.2) to provide the kind of norms that might have prevented the financial scandals that previously occurred. The Rule says that a lawyer who is employed or retained by an organization must, "if necessary... to cause the wrongful conduct to be stopped, advise progressively the next highest persons or groups, including ultimately, the board of directors, the board of trustees, or the appropriate committee of the board, that the conduct was or is dishonest, fraudulent, criminal, or illegal and should be stopped..."

For in-house lawyers, this was not a huge conceptual stretch – escalating a matter up to the board to seek a satisfactory resolution is consistent with the lawyer's duty to the organization as a whole. Still, the practical implications can be significant.

Professor **Lorne Sossin** of the University of Toronto's Faculty of Law notes that being hired by the board rather than by the president or CEO would bolster the independence of in-house counsel. "You want to ensure that when necessary, in-house counsel can have *in camera* access to the board, to discuss matters of 'up-the-ladder reporting,' among other things. That's



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difficult when in many organizations, it's the president who does the hiring and firing of counsel."

David Brennan, senior vice president, law and general counsel at Ontario Power Generation Inc., warns that making the in-house counsel answerable to the board may have the unintended consequence of actually limiting counsel's ability to discover – and challenge – corporate misconduct. "If I was the CEO, then I would see the counsel as a person whose ultimate allegiance is not to me, but to the board. And I am going to control the information that that person is going to see. He would only be allowed to see the same information that I would let the board see."

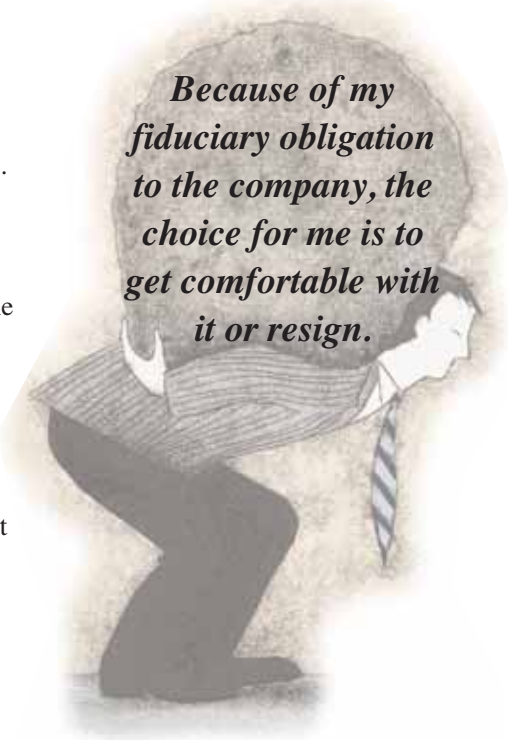
Sossin acknowledges there is no "silver bullet" to preserve in-house counsel's professionalism. There are inherent tensions. "How do they work collaboratively with senior management while retaining a separate and independent role, when it's necessary, in advising the board?"

He is "a little bit skeptical" that Rule 2.02 has indeed led to more

up-the-ladder reporting. But he does believe it has encouraged a culture of oversight and accountability within organizations and attention to special obligations on counsel that can deter misbehaviour. "What we want is not a situation where there is reporting, but rather a situation where there is nothing to report."

Indigo's Flynn agrees and suggests that Rule 2.02 has, on the one hand, heightened in-house counsel's sensitivity to reporting misconduct while, on the other, made them feel more vulnerable. "I think for some in-house counsel, it has created dilemmas and put them in a situation where they may have to make a career-limiting decision. Does that increase their sense of independence? It has certainly increased their duty of independence."

Rule 2.09 (7) (d.1) on mandatory withdrawal specifically states that a lawyer shall withdraw if the lawyer is required to do so pursuant to Subrules 2.02 (5.1) or (5.2)" dealing with dishonesty and fraud on the part of a client that is an organization.

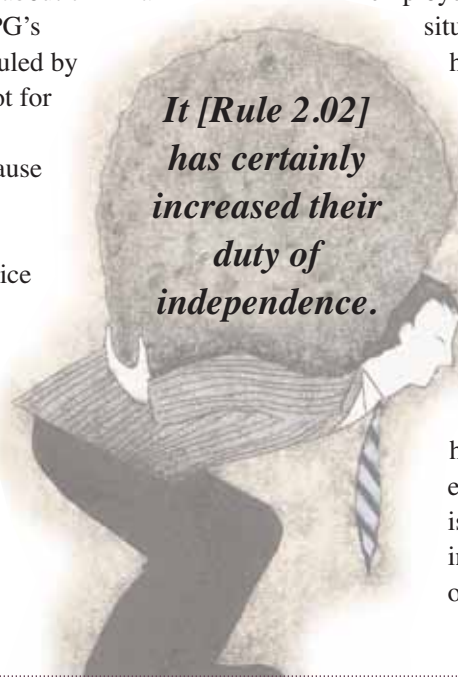


Because of my fiduciary obligation to the company, the choice for me is to get comfortable with it or resign.

While up-the-ladder reporting appears to have been widely accepted by in-house counsel, a huge controversy surrounded the U.S.'s initial SEC proposal that, if nothing happens to resolve the issue *within* the organization, the lawyer would be required to report *outside*. The proposed SEC rule called for counsel to make a "noisy withdrawal" whenever a client had not adequately addressed "evidence of a material violation" of the securities laws. U.S. lawyers vigorously opposed the proposed SEC Rule, arguing that it would violate the traditional lawyer-client relationship. This view ultimately prevailed.

In Canada, when considering the amendments to the Rules in 2004, the Professional Regulation Committee declared, "The confidentiality standard is central to the integrity of the up-the-ladder reporting regime. If the openness and candour of the lawyer and client relationship is compromised, the lawyer is much less likely to become aware of improper conduct and to be in a position to counsel the client against it or take appropriate steps to address it."

"I'm not sure I would ever go outside the company on an issue – assuming we're not talking about criminal activity," says OPG's Brennan. If overruled by the board, "It's not for me to go to some higher body. Because of my fiduciary obligation to the company, the choice for me is to get comfortable with it or resign. I don't see a third alternative. I'm bound [by solicitor-client privilege] to not say anything."



It [Rule 2.02] has certainly increased their duty of independence.


There are, however, limited circumstances other than financial irregularities in which in-house counsel are permitted to override their duty of confidentiality and disclose information to appropriate authorities. Rule 2.03 (3) provides: "Where a lawyer believes upon reasonable grounds that there is an imminent risk to an identifiable person or group of death or serious bodily harm, including serious psychological harm that substantially interferes with health or well-being, the lawyer may disclose, pursuant to judicial order where practicable, confidential information where it is necessary to do so in order to prevent the death or harm, but shall not disclose more information than is required."

Says Brennan, "If it were a criminal matter, I would be seeking my own independent legal advice. And if my concern was imminent health issues, I would be getting that advice very quickly."

Asked about the question of disclosure, O'Toole says, "That's a situation that I've never encountered and would be very unlikely to encounter here because of the values and principles that P&G promotes among its employees. But in a hypothetical situation, I would probably

have to consult the Rules and of paramount importance would be my obligation as a lawyer." He would turn to the Law Society's confidential practice resource service for advice. "There's also the opportunity for in-house counsel to consult external counsel on any issue related to practice, including ethical obligations."

But, says O'Toole, "with all of these ethical questions – whether in a recession or not – it comes down to the personal ethics of the lawyer. I have no problem exercising my viewpoint and providing counsel, even if it's contrary



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to the desires or the plans of one of my internal 'clients.' To do the job well, you have to have the personal confidence to provide counsel in a collaborative way but in a resolute way as well.

"I usually like to preface some of my difficult advice to clients by saying, 'I'm the guardian of the brand equity of the company. You don't want to jeopardize the corporate reputation based on a short-term opportunity.' That would be pivotal for in-house counsel, and if they're not prepared to take that role seriously, they might be in the wrong profession." ■