

Some Misperceptions Among Corporate Lawyers

BY STEPHEN GILLERS

If you spend time talking to lawyers about ethics you soon discover an interesting misperception. Too many corporate and transactional lawyers believe the rules are not meant for them, not as a practical matter anyway, but rather for their litigating colleagues. This of course is wrong. The work of a law firm's corporate lawyers is circumscribed by the clients of its litigators and vice versa. And any firm lawyer's professional lapse may create liability for the firm and, depending on how the firm is organized, all of its partners. Even if a firm is organized in a way that limits liability, a corporate lawyer on a firm's executive committee (and who therefore has the augmented supervisory responsibilities in Canon 1 of the Code) may find herself civilly and professionally liable for the acts of others.

Beyond this "we are all one" reality is the additional fact that some regulatory issues directly affect corporate lawyers wherever they practice. Here's an introduction to a few of them with more to come next month.

The New York Code vs. The Model Rules

The ABA's Model Rules are a guide for New York lawyers, but they are not the bible — the New York Code of Professional Responsibility is. The New York Code "cherry picks" portions of the Model Rules dealing with the responsibility of lawyers for organizations. But it also makes changes. "Organization" is a word of art here. An "organizational client" is said to be "a legal entity." (Model Rule 1.13 Comment [1]). Organizations or entities are usually corporate but they need not be. These rules would also apply to unincorporated associations like labor unions, trade associations, partnerships, and even joint ventures. *See, e.g., NYC Opinion 1994-10.*

DR 5-109(B), taken from Model Rule 1.13(b), contains the so-called "climbing the ladder" directive. When a lawyer employed or retained by an organization learns that a constituent of the organization (officer, employee, or other) is acting or failing to act in a matter that could violate a legal obligation to the organization, or is engaging in a violation of law that could be "reasonably" imputed to the organization, the lawyer is told to proceed "as is reasonably necessary in the best interest of the organization" if the result of the conduct is likely to be "substantial injury to the organization." The entity lawyer is then given a number of possible alternatives. The list is not meant to be exclusive. The lawyer is told to exercise judgment after considering the seriousness of the conduct, the nature of the lawyer's representation, the person involved, and the seriousness of the consequences of the conduct.

However, the options explicitly given to the lawyer include, at their most aggressive, referring "the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law." That "highest authority" is generally taken to mean the board of directors, not shareholders.

If the lawyer's efforts prove unavailing, the lawyer is told that he or she has the option to resign pursuant to DR 2-110. "Whistleblowing" is not explicitly recognized in DR 5-109 but neither is it explicitly rejected. Rather, whether a lawyer may or must reveal the information described in the rule to others will depend on other rules, including DR 4-101 and DR 7-102(B) (or Model Rules 1.6 and 3.3). As it happens, New York's list of permissive exceptions to confidentiality in Canon 4 are much broader than those in Model Rule 1.6 (although an ABA Commission is on the verge of expanding the Rules' confidentiality exceptions). On the other hand, Model Rule 3.3 says that a lawyer's duty to reveal client fraud to a court is superior to his confidentiality obligations. DR 7-102(B)(1) says the opposite.

One issue that may confront a lawyer for an entity — and remember that we are dealing not only with employed lawyers but also retained lawyers — is the responsibility of the lawyer when speaking with a constituent of the entity whose interests may be adverse to the interests of the entity but who may believe, wrongly perhaps, that the lawyer is his or her lawyer as well. The Model Rules requires the lawyer to "explain the identity of the client when it is apparent that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing." The New York analog gives greater protection to the constituent. It requires a warning whenever "it appears that the organization's interests may differ from those of the constituents with whom the lawyer is dealing." In other words, a conscious decision was made to deviate from the text of the Model Rule.

Consequently, a New York lawyer will more likely be in a position to have to give a corporate constituent "Miranda warnings" than will a lawyer operating under the Model Rule.

Who Is The Client?

A lawyer who represents an organization does not thereby represent its constituents. The Model Rules phrase the situation this way: "A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents." In New York, Ethical Consideration 5-18 states: "A lawyer employed or retained by a corporation or a similar entity owes allegiance to the entity and not to a shareholder, director, officer, employee, representative, or other person connected with the entity."

The issue of client identity can arise in many settings. Entity constituents may sue the entity lawyer on a theory that requires a professional relationship between them. But the mere fact that the lawyer represents the entity will not suffice to create an attorney-client relationship with a constituent. The situation may also arise when a constituent alleges that the lawyer's representation of the entity creates a conflict of interest because of a professional duty owed to the constituent as a client, or where the constituent claims that communications with the lawyer are privileged to the constituent.

In the absence of evidence establishing a separate professional relationship between the lawyer and the constituent, none will likely be inferred simply because the constituent communicated with the lawyer or received advice from the lawyer on a matter in which the constituent, in addition to the organizational client, had an interest. This is especially so if the constituent is high up and therefore deemed sophisticated in these matters. Conversely, the representation of a constituent will not translate into the representation of the entity a constituent serves. In fact, representation of both a constituent and an entity may create conflicts of interest that warrant disqualification. Companies should consider that danger before authorizing their own lawyers to attend to the personal legal problems of their officers.

Careful lawyers will avoid any uncertainty by making their loyalties clear early on whenever circumstances warrant.

Corporate Lawyers With Business Roles

Lawyers who perform legal services for corporations or other entities, and especially lawyers who are employed by the entity, may also perform work that is not legal work. The title “Vice President and General Counsel” signals just such a duality. The lawyer for a corporation may also serve on its board. No rule forbids that. Any corporate lawyer may give business advice or participate in strategic planning or other work commonly associated with the jurisdiction of corporate directors and officers. All that is fine, so long as the lawyer, and especially the client, are prepared to assume the risks associated with multiple roles.

Among these risks are threats to privilege, threats to the exercise of independent professional judgment, and potential civil liability. Let’s start with the last first. A lawyer who performs nonlegal services is as exposed as any other officer and director to liability for malfeasance or nonfeasance. **A lawyer who does this while also a partner at a law firm risks imputing that liability to his or her firm.** Of course, insurance may cover it, but the risk is there.

With regard to the threat to independent professional judgment, the danger may be more theoretical than real but cannot be entirely discounted. The lawyer who performs nonlegal work for the corporate client in effect becomes the client. That is most obvious for the lawyer who sits on a client board of directors because the board is ordinarily the highest body able to speak for the corporation. But it is also true for lawyers who participate in the business of the organization, broadly defined. In either capacity, a lawyer is investing a portion of his or her time and skill in those business decisions the lawyer helps make for the client.

In the lawyer’s role as a lawyer, however, he or she is expected to act as a check on legally risky decisions – to advise against them and possibly to insist that particular action be rejected. It becomes harder for the lawyer to fulfill that role if she sees herself as a “player” in the business of the company, working with the other officers to increase its profit. It also becomes harder for the other officers to view the lawyer as the independent and disinterested counselor envisioned by the traditional lawyer role.

Limits On Privilege

It is on the subject of privilege that the greatest risk occurs. Foremost, perhaps, is the danger that company personnel, familiar with a lawyer’s general obligation of confidentiality and privilege, will speak freely to the lawyer when the lawyer is occupying a nonlegal role and the communications will therefore not be protected as privileged. In other words, confusion of roles can lead to denial of privilege. Precaution is useful but no guarantee.

So long as a lawyer occupies multiple roles, opponents of the client will always have the ability to argue that communications with a lawyer were predominantly in his or her business, and not the lawyer's professional, capacity. Lawyer and client may proceed in the good faith belief that particular communications are protected as privileged, but a court may surprise them. If a lawyer occupies a single position in the company only, then this risk is much reduced if not eliminated.

Georgia-Pacific Corp. v. GAF Roofing Manufacturing Corp., 1996 WESTLAW 29392 (SDNY 1996) (Patterson, J.), revealed the danger of confused roles. It alarmed many in the corporate counsel community. It justified some alarm but probably not as much as it provoked.

Scott, a lawyer in-house at GAF, negotiated the environmental provisions of a proposed contract between GAF and GP. Concurrently, he advised GAF officers on the legal effect of the proposed environmental provisions. Eventually, GP sued GAF. Scott's deposition was noticed. He refused to reveal what recommendations he had made to other GAF negotiators or the communications he had had about the agreement with GAF personnel.

The court rejected the claim of privilege. It recognized that in-house lawyers, no less than outside lawyers, can have privileged communications with their clients. But when an in-house attorney communicates with management, "difficult fact-specific questions are involved." No privilege attaches when a lawyer acts as a business advisor. The court then held that as "a negotiator on behalf of management, Mr. Scott was acting in a business capacity" His conversation with GAF officers "involved business judgments and environmental risks. Such reporting of developments in negotiations, if divorced from legal advice, is not protected by the privilege under New York law."

Unfortunately, the court's conclusory language fails to explain why the fact that Scott was also advising GAF on the legal import of proposed language did not suffice to privilege the discussions. Two of the questions posed to Scott at his deposition seemed to elicit this very advice. So while the court states all of the principles correctly, its particular application of them to the facts before it remains obscure. The opinion is best read as a failure by GAF to carry its burden of proving that the lawyer's work was predominantly legal (a prerequisite to privilege) and not predominantly business advice.

Lawyer As Negotiator

One reason the case engendered alarm is that Scott's particular work was negotiation and lawyers frequently negotiate. In negotiation, lawyers do things that ordinary business people also do. Both will then report back to company officers. Is this reporting back now outside the protection of privilege because nonlawyers also negotiate and report back?

In negotiations and reporting back, lawyers, unlike lay counter-parts, concurrently draft and evaluate the legal meaning of proposed language. So should that make a difference? It didn't for Scott. And it will be hard for lawyers to parse negotiations and allocate the amount of time or effort spent on the "business" side and the amount spent on the "legal" side. If nevertheless it is the burden of the party asserting privilege to be able to show that the lawyer's work was predominantly legal, the alarm GAF prompted is understandable.

The opinion has not been cited by other courts, nor have we seen a judicial willingness to presume that a lawyer's mixed purpose negotiations are predominantly business related. Nevertheless, the case stands as a warning that companies that use lawyers to negotiate, and wish to maintain privilege for ensuing conversations with officers about these negotiations, should be prepared to present a plausible oral, and if possible a written, basis on which a court can conclude that the decision to assign a lawyer the negotiating task was predominantly motivated by legal considerations. In a matter of significant import, a company may instead choose to have its business people handle negotiations, with lawyers on the sidelines giving advice.

Next month: Who controls the attributes of the attorney - client relationship following mergers and acquisitions and what you can do to change that.

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