

# Tough Calls



Drawing

**I**n-house counsel have it harder than their private practice counterparts when it comes to professional ethics. After all, they are enmeshed in the client, and the advice they provide is not exclusively legal. So the clearly prescribed rules that govern the attorney-client relationship grow a little fuzzy at the edges when counsel aren't diligent about constantly defining their context.

"It's easy for the managers and executives to view in-house counsel as more than just an attorney who is working for the company," says Daniel Sulton, a partner at Ford & Harrison and a former in-house attorney. "That's a blessing and a curse."

In other words, the very aspect of in-house practice that is usually most attractive—the opportunity to work in close partnership with the business—is precisely what makes in-house ethical considerations nettlesome.

The word ethics is something of a misnomer in the legal profession, and usually pertains to rules of conduct. More rarely do ethics arise in a classical sense—the weighty dilemmas that pit what is right against what is strictly legal. In either case, lawyers face the unsettling task of weighing competing duties.

## the line on ethical decisions can be tricky for in-house counsel.

By Steven Andersen

*Illustrations by  
Marilyn Janovitz*

"In-house counsel have to be concerned with their obligations to their client as well as to the state in which they are licensed. They also have obligations as members of a learned profession," says Michael Rubin, a McGlinchey Stafford member who frequently lectures on ethics issues. "One hopes that those interests will coincide, but sometimes there is tension."

We asked ethics experts and current and former in-house counsel to describe those tensions and walk through several scenarios in which in-house attorneys face difficult ethical decisions. We chose three commonplace situations: disclosure, financial reporting and internal investigations. The fourth, quitting your job on ethical grounds, is rare but extremely sensitive. In each scenario, the general counsel must make a judgment call—a subjective decision on where to draw the line as to what is material, what is probable or what lies within their purview.

Experience is your best ally in such cases. Advice from mentors and outside counsel helps. But in the end, you make the call alone.

# Case 1: Disclosure

## Dos and Don'ts

EVERY PUBLIC COMPANY'S GENERAL COUNSEL FACES disclosure decisions about what crosses the materiality threshold and when to let the world know. But in smaller, innovation-driven companies, those issues are amplified. Because such businesses are usually in a money-raising mode, publicity both drives the business and opens the floodgates of what can be construed as material.

Jeff Miller has wrestled the issue from every conceivable angle. His CV reads like a virtual tour of the new economy. He spent most of the past three decades as the general counsel or CEO of a string of West Coast biotech and e-commerce firms, including NeoRx Corp., Ostex International Inc., Reprogen Inc. and aQuantive Inc. When it comes to disclosure, he says GCs rarely, if ever, have bright-line standards to follow.

"I've been in board meetings where I said we had to disclose something and a board member argued that it would hurt the shareholders," Miller says. "I had to ask, 'Which shareholders are you talking about, the ones that are selling or the ones that are buying?'" That's the dilemma."

Miller says biotechs can be rife with disclosure issues because their aggressive PR stance leads them to announce every clinical trial, research breakthrough or new contract.

"My fear was always what would happen if we lost one of those clients," he says. "Have we raised this thing to the level of materiality at which we have to go out and publicly say that we lost the client? If you make a big deal out of your Phase II study and it fails, you have a disclosure issue. The question is, when do you determine whether the study fails? Do you wait until the final data comes in? If you see the data has a downward trajectory, do you do it sooner? It gets complicated."

The equation is difficult. If you get sued, damages come into play, and the longer you sit on bad news the greater the damages. Early disclosure tends to be the best policy, but the decision is never cut-and-dried. Miller says outside counsel can help, but there's a limit to their perspective.

"Outside counsel are geniuses at assessing possibilities: what can go wrong. What they're really bad at is assessing probabilities," he says. "If you ask them the likelihood those things will go wrong, they'll typically say 50-50."

While it may not be easy or pleasant, the very core of the general counsel's job is to assess the risks in light of specific business needs and weigh what could happen with what might happen.

"Of course that creates some ethical issues because if you're



w r o n g , people can get hurt," Miller says. "The very definition of ethics is the relationship between behavior and undue harm."

Miller faced one of his most challenging disclosure issues when he was senior vice president for legal and privacy affairs at aQuantive, a Seattle-based Internet advertising company. Miller, who is currently of counsel to Perkins Coie, is free to discuss the situation now because aQuantive was acquired by Microsoft in 2007.

The company, which went public in 2000, initially used a controversial but legal accounting technique in which so-called pass-through costs were recorded as revenue. The company collected money from clients, bought advertising with it and marked up the advertising cost because the firm was adding value by tracking the ads online. aQuantive showed the money that passed through from clients to advertisers as revenue. Ad firms typically show that as cost.

"Frankly I was surprised the SEC allowed us to do that, but I said, 'As long as it's OK with the SEC, it's OK with me,'" Miller recalls. "About two years later, the board composition changed and the board became uncomfortable with the accounting methodology and wanted to change it. That would have required restating a couple years of financials, which is the third rail of shareholder liability cases. When you restate, 99 times out of 100 you're going to get sued."

Still, the board wanted to press on. Miller conceded, but got the board to agree to a compromise. They would make the restatements, but only after they conditioned the market for a year. For the next four quarters, a statement about the pending accounting change and restatement accompanied the earnings report. The release stressed that the change was procedural and did not reflect any underlying shift in value.

"A year went by, we made the accounting change, and it didn't raise an eyebrow in the market," Miller says. "It didn't change the stock price. There was no lawsuit. Sometimes you can find solutions, and that's what the general counsel does."

## Case 2: Reporting Rights & Wrongs

IN TODAY'S CLIMATE OF INTENSIFIED individual accountability, there's an ever-growing queue of certification-seeking auditors outside the GC's office. But signing off on everything that comes across your desk is ethically dodgy.

"We as lawyers, under our code of ethics, can only sign what we are competent to sign," says Rosemary Corsetti.

The straight-speaking general counsel of Covenant Dove, a Memphis-based chain of 38 nursing homes, Corsetti has a direct method of confronting gray areas. She draws a line in the sand.

"The auditors come forward and say, 'Sign these affidavits that show the company is in compliance with all these laws,'" she says. "A lot of those audit requirements are more in the purview of financial people. I'm not the one who keeps the books, so how can I, as a lawyer, say that everybody is doing what they are supposed to do? I have a real problem with that. It's not that the company is doing something wrong, but how do you know what people are doing on a day-to-day basis?"

Corsetti, who previously was general counsel to Tandem Health Care, says GCs face significant pressure to just sign on the dotted line. Those who resist may be accused of knowing about or covering up some sort of wrongdoing. If that tack fails, loyalty can come into question.

"The pressure is: 'You know, your CFO already signed off on it, aren't you going to rely on him?' Well no, if something comes back to me, you're going to ask me why I signed it," she says. "The CFO is closer to it. They should sign it. That's the part of the business that they run."

Auditors who are under heightened scrutiny themselves often lump general counsel in with other C-level executives and are insistent on getting their signatures. Corsetti acknowledges that a lot of large company lawyers may also be CPAs or MBAs, and perfectly capable of

financial certification. But counsel whose expertise is limited to legal matters—as is the case with many small-department counsel or solo GCs—should resist any pressure to step beyond their formal role.

"I have asked for amendments to the affidavits as they relate to me as general counsel," she says. "In my knowledge as general counsel, and not as a

finance adviser to this organization, this is what I know."

That approach upholds her ethical responsibilities, but she admits it goes over like a lead balloon.

"It's not easy," Corsetti says. "There's a big pushback and they don't like it one bit. Because they're trying to protect themselves, the auditors' requirements are so detailed that they put senior management on the spot. That really puts the in-house counsel in a bind. I try to limit my role to [that of] a lawyer."



## Case 3: Investigation Ins & Outs

ANY TIME IN-HOUSE COUNSEL CONDUCT internal investigations, they directly confront ethical issues. The ABA Model Rules of Professional Conduct, which most states have adopted with minor variations, clearly state the client is the corporate entity, not the executives, directors or employees. But managing that distinction on a practical basis is challenging.

Although investigations can arise in any context, from financial fraud to

Foreign Corrupt Practices Act violations, the most common context is labor and employment. Whether it's a harassment claim, a whistleblower situation or merely a violation of company policy, professional ethics can get tricky when conducting internal investigations.

"Who should conduct the investigation is really a threshold question," says Daniel Sulton, a partner at Ford & Harrison. "Oftentimes companies want in-house counsel to conduct the inves-

tigation, particularly if the matter is complex or sensitive. That raises an ethical issue for the attorney because the ABA model rules [Section 3.7] indicate that the attorney could be disqualified from representing the company in any subsequent trial related to that action."

Until fall 2008, Sulton was an in-house labor counsel at Scana Corp., a gas and electric utility in the Southeast. He says companies should have a non-attorney work in tandem with any in-

### Case 3: Investigation *continued from page 54*

house counsel conducting an investigation if they want to prevent the lawyer from being tagged a “necessary witness” under the code.

“If a company wants to use the fact that it conducted an investigation as a part of its defense, then the attorney probably would be disqualified because the attorney would be the only one with knowledge of the entire investigative process,” Sulton says.

The greater issue, however, is establishing to all parties involved that in-house counsel only have one client.

“Under Rule 1.13, the client is always going to be the company,” Sulton says. “As long as it’s clear that the client is the company, not any individuals, there usually won’t be a problem. But if there is a conflict between those agents and the

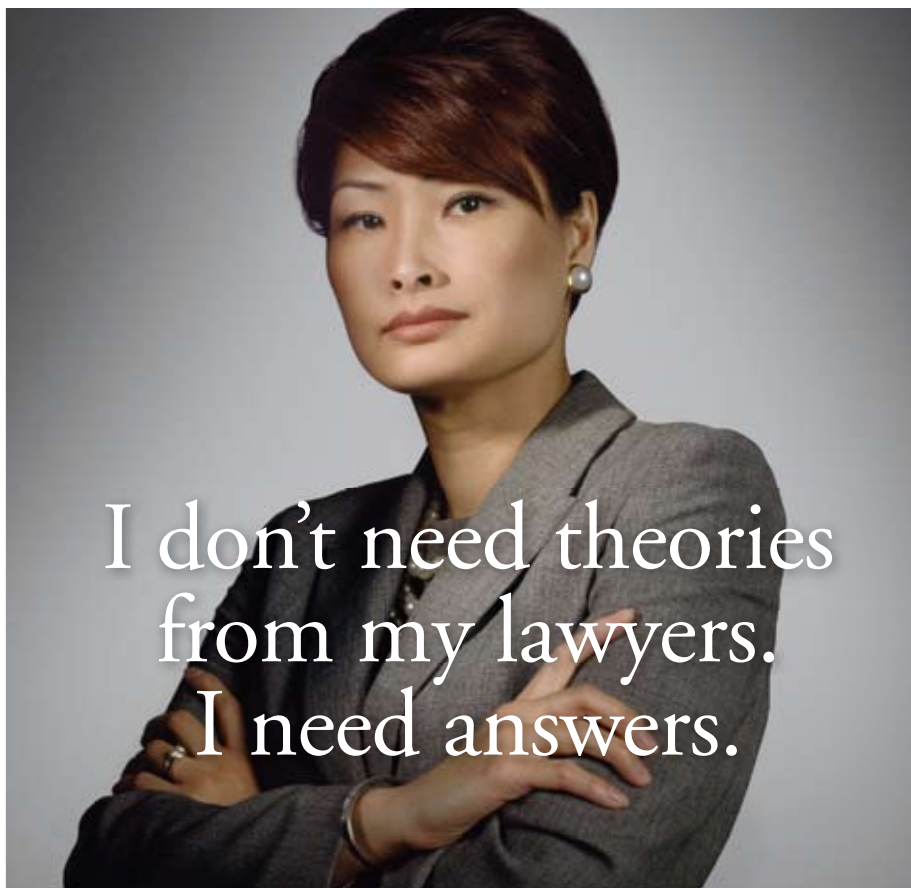
company itself, the attorney has an obligation to remain loyal to the company.”

Tension also arises when the investigation pits individuals against each other, as in a harassment case. There can be a natural desire on the part of the lawyer to provide advice to the individuals, Sulton says, but they must resist the temptation.

“Because the attorney is in-house, you often get to know the employees you are working with. It’s one of the reasons companies like in-house counsel to conduct the investigations,” he says. “Employees are more familiar with them and will be more likely to loosen up and share information. But in-house counsel need to remember that yes, you may



have a familiar relationship, but you’re still bound by ethical obligations” (see “Client Conflict,” p. 10).



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## Case 4: Withdrawal

### When & How

CLIENT CONFIDENTIALITY IS THE CORNERSTONE OF THE LEGAL profession, but in certain situations the lawyer is ethically bound to breach that trust. If the attorney's services are being used to further a crime, or if there is a reasonable certainty substantial harm or death will result, the lawyer has a duty to act.

But understanding what is reasonable can be difficult. Consider a scenario where a critical difference of opinion exists within an organization: The company is about to bring a new product to market. A key engineer believes the product has a potentially fatal defect, but other researchers disagree. The company is heavily invested in the product and management wants to push on, but the general counsel is inclined to believe the engineer.

"There is a tension," says Michael Rubin, the McGlinchey Stafford member and ethics lecturer. "Unless the client has released you from the confidence, there is danger if you say anything to anyone."

The GC, he says, has three choices: Somehow convince the management team to change its mind, acquiesce and remain employed, or resign. If you choose option C, one more critical decision awaits you.

"There are some cases that talk about the noisy withdrawal, where you tell the new general counsel, a regulator or some other person that you withdrew because you had an ethical issue," Rubin says. The noisy withdrawal is a controversial and hotly debated topic. In some states, the rules of conduct directly address the option. Other states don't mention it at all. The ABA model rules don't engage the issue directly, although the comments do discuss it.

A noisy withdrawal is perhaps the most incendiary action a lawyer can take. It broadcasts that wrongdoing has taken place, as was the case in the recent example of an outside counsel who disavowed his representation of one of billionaire Robert Allen Stanford's investment firms. Proskauer Rose partner Thomas Sjoblom uncovered the fraud, terminated the client relationship and sent the SEC a letter retracting all previous communication.

Needless to say, a noisy withdrawal is a proverbial nuclear

option, and in anything less than a clear-cut case of criminal action, the lawyer is on very thin ice.

"It comes down to what you view the lawyer's primary duty to be," Rubin says. "One view is that if the client is not breaking the law, who are you to put your personal feelings above what's best for the company? The other view is that the lawyer owes a higher duty to society, the court system or some other entity. Then the question is, 'Who is to judge that?' There is no easy answer." n

