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Corporate Responsibility: Ensuring Independent Judgment of the General Counsel - A Look at Stock Options

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CORPORATE RESPONSIBILITY: ENSURING INDEPENDENT JUDGMENT OF THE GENERAL COUNSEL—A LOOK AT STOCK OPTIONS

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Former chief corporate counsel [of Tyco] is indicted on grand larceny in Manhattan.[1]

SEC files charges against former chief legal officer of Tyco.[2]

Former chief counsel of Rite Aid convicted.[3]

WorldCom general counsel resigns amid allegations of fraud.[4]

I. INTRODUCTION

Recent corporate scandals and allegations of corporate fraud in public companies have most people asking how things went so wrong.[5] Many

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1. Greg Levine, *Merck's Anstice Won't Budge; Tyco Ex-Lawyer Belnick: I'm Innocent*, Feb. 4, 2003, http:// www.forbes.com/2003/02/04/0204facesam_print.html; Kara Scannell & Laurie P. Cohen, *Leading the News: Charges Against Tyco Ex-Counsel Expand to Include Grand Larceny*, WALL ST. J., Feb. 4, 2003, at A3; Cable News Network, *Ex-Tyco Counsel to Stand Trial*, Aug. 13, 2003, http://cnnmoney.printthis.clickability.com/pt/cpt?action=cpt&expire=&urlID=7196587&fb. . .; The Blue Sage Group, *Tyco Scandal*, http://www.thebluesagegroup.com/scandal_tyco.htm (last visited July 20, 2005).

2. Press Release, United States Securities and Exchange Commission, Litigation Release No. 17722 (Sept. 12, 2002) (on file with author); Cable News Network, *Three Tyco Execs Indicted for Fraud*, Sept. 12, 2002, http://cnn.worldnews.printthis.clickability.com/pt/cpt?action=cpt&expire=-1&urlID=4688

3. *Executives on Trial: Rite Aid Ex-Counsel is Convicted,* WALL ST. J., Oct. 20, 2003, at C8.

4. Caron Carlson, *WorldCom Woes Hit Users*, June 16, 2003 (on file with author), http://www.eweek.com/article2/0,1759,1128529,00.asp.

5. *See* Alexei Barrionuevo & Jonathan Weil, *Partner Warned Arthur Andersen on Enron Audit*, WALL ST. J., May 9, 2002, at C1 (chronicling internal communications regarding Arthur Anderson's audits for Enron).

blame corporate corruption on the lack of board leadership.[6] Others blame corporate financial fraud on accounting firms and other corporate gatekeepers' failure to do their jobs.[7] Most Americans blame such corporate debacles on executive greed.[8] Still others consider the growth in executive compensation and stock option grants as catalysts for corporate greed.[9] Pressure on corporate executives to keep the stock price up for short-term goals and to maximize equity wealth for personal gain have created corporate environments where financial mismanagement is tolerated, if not encouraged.[10]

When looking to assess blame for corporate malfeasance, many ask, "Where were the lawyers?"[11] In several high-profile corporate fraud investigations, outside and in-house lawyers were criticized for not doing more to prevent corporate executives from violating the law, and several general counsels were charged with criminal misconduct by state and federal authorities.[12] Why would the general counsel of a public corporation risk his or her career, reputation, and criminal prosecution to assist

6. *See* Tom Becker, *Delaware Justice Warns Boards of Liability for Executive Pay*, WALL ST. J., Jan. 6, 2003, at A14 (reporting comments made by the chief justice of the Delaware Supreme Court on the legal liability of corporate directors); Carol Hymowitz, *Corporate Governance: How to Fix a Broken System*, WALL ST. J., Feb. 24, 2003, at R1 (suggesting ways to change the composition and standards of corporate boards); Berkshire Hathaway, Inc., 1998 ANNUAL REPORT 13-15 (Mar. 1, 1999), *available at* http://www.berkshirehathaway.com/1998ar/impnote98.html (describing changes to the corporation's stock option plan in response to recent national corporate scandals).

7. *See* John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid,"* 57 BUS. LAW. 1403, 1409 (2002) (examining the failure of corporate watchdogs, auditors, analysts, and debt rating agencies to detect Enron's collapse).

8. John Cassidy, *The Greed Cycle: How the Financial System Encouraged Corporations to go Crazy*, THE NEW YORKER, Sept. 23, 2003, at 1.

9. *Id.* at 3-4.

10. *Id.* at 6-7.

11. David J. Beck, *The Legal Profession at the Crossroads: Who Will Write the Future Rules Governing the Conduct of Lawyers Representing Public Corporations?*, 34 ST. MARY'S L.J. 873, 874 (2003); Susan D. Carle, *The Evolving Legal and Ethical Role of the Corporate Attorney After the Sarbanes-Oxley Act of 2002: Panel Three: Ethical Dilemmas Associated with the Corporate Attorney's New Role*, 52 AM. U. L. REV. 655, 661 (2003); Jenny B. Davis, *The Enron Factor: Experts Say the Energy Giant's Collapse Could Trigger Changes in the Law That Make it Easier to Snare Professionals*, 88 A.B.A. J. 40, 45, 61 (Apr. 2002); Neil Hamilton, Commentary, *Counseling on Business Ethics After Enron and WorldCom*, MINN. LAWYER, Aug. 12, 2002 at 1; Mike France, *What About Enron's Lawyers?* (Dec. 23, 2002) (on file with author), http://www.chesslaw.com/buprof.htm. *See also* Perry Wallace, Jr., *The Evolving Legal and Ethical Role of the Corporate Attorney After the Sarbanes-Oxley Act of 2002: Panel 1: The Collapse of the Corporate Model*, 52 AM. U. L. REV. 579, 580 (2003) (asking generally "What went wrong?" in terms of the corporate scandals of the time and also what led to those scandals).

12. Christina R. Salem, Note, *The New Mandate of the Corporate Lawyer After the Fall of Enron and the Enactment of the Sarbanes-Oxley Act*, 8 FORDHAM J. CORP. & FIN. L. 765, 766-67 (2003); Chief Justice E. Norman Veasey, *The Ethical and Professional Responsibilities of the Lawyer for the Corporation in Responding to Fraudulent Conduct by Corporate Officers or Agents*, 70 TENN. L. REV. 1, 2 (2002).

executives in perpetuating corporate fraud? While there is no simple or single explanation, an answer may be in the purported reason for corporate greed and ultimately corporate fraud—the desire for equity wealth. The recent indictments of general counsels at some major corporations suggest that some corporate attorneys not only may have failed to meet their legal obligations, but they also may have failed to meet their professional responsibilities to protect the interests of the corporation, and have succumbed to corporate cultures of avarice.[13]

Independent judgment is a hallmark of lawyer integrity,[14] and corporate lawyers bear some of the responsibility for corporate wrongdoing.[15] Public company failures resulting from financial fraud and disclosure misrepresentation raise questions of whether the general counsel's independent judgment is too highly influenced by loyalty to superiors.[16] The chief legal officer ("CLO") or general counsel[17] of a public company is not only uniquely positioned to advise his or her client on any legal pitfalls of a business transaction, but also on what ethical issues are raised in business decisions.[18] Investor confidence in corporate public disclosures and trust in the corporate governance systems of public companies' boards are dependent on the integrity of all its gatekeepers.[19]

This article generally explores the issues of whether stock options granted to the general counsel increases the financial dependence of the

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13. Roger C. Cramton, *Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues*, 58 BUS. LAW. 143, 144-45 (2002); Mary C. Daly, *The Cultural, Ethical and Legal Challenges in Lawyering for a Global Organization: The Role of the General Counsel*, 46 EMORY L.J. 1057, 1061-63 (1997).

14. *See generally* A.B.A. CENTER FOR PROF'L RESPONSIBILITY, MODEL RULES OF PROF'L CONDUCT PREAMBLE & SCOPE, at 1-2 (2003); Susanna M. Kim, *Dual Identities and Dueling Obligations: Preserving Independence in Corporate Representation*, 68 TENN. L. REV. 179, 188 (2001) (presenting the ideal that lawyer independence is "non-negotiable" because it is a duty owed to the legal profession).

15. Kim, *supra* note 14, at 207; Susan P. Koniak, *Regulating the Lawyer: Past Efforts and Future Possibilities: When the Hurlyburly's Done: The Bar's Struggle with the SEC*, 103 COLUM. L. REV. 1236, 1237-38, 1240, 1245 (2003).

16. Kim, *supra* note 14, at 184; Irma S. Russell, *Keeping the Wheels on the Wagon: Observations on Issues of Legal Ethics for Lawyers Representing Business Organizations*, 3 WYO. L. REV. 513, 517-18 (2003). *See also* MIMI SWARTZ WITH SHERRON WATKINS, POWER FAILURE: THE INSIDE STORY OF THE COLLAPSE OF ENRON 228, 251-52, 302, 309, 326 (Doubleday, 2003) (chronicling participation and loyalties of Enron's general counsel).

17. This article uses the terms chief legal officer and general counsel interchangeably. Both terms are used to define the head legal counsel employed by a public corporation.

18. John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 COLUM. L. REV. 1293, 1296, 1298 (2003); Russell, *supra* note 16, at 514; Richard W. Painter, *The Moral Interdependence of Corporate Lawyers and Their Clients*, 67 S. CAL. L. REV. 507, 513-514 (1994).

19. *See* Coffee, *supra* note 7, at 1405; Thomas H. Watkins, *Ethics: Are Lawyers the Last Line of Defense for Critical Accounting, Corporate Governance and Auditing Issues Under Sarbanes-Oxley?*, 735 PLI/PAT 531, 555-56, 564-65 (2002).

general counsel on a single client, aligns the financial interests of the general counsel too closely with the financial interests of senior management, and risks the loss of independent judgment and candor by the general counsel.

More specifically, Part II of the article reviews the role of the general counsel in public companies, the growth in salary and stock option compensation for the general counsel, the use of stock options in executive compensation, and introduces a discussion of the Sarbanes-Oxley Act and recommends changes to the Model Rules of Professional Conduct for attorneys. Part III more closely reviews the American Bar Association ("ABA") Model Rules of Professional Conduct and specifically analyzes Model Rule 1.7 on Conflict of Interests and its application to the general counsel for maintaining independent judgment. This part argues that Model Rule 1.7 fails to address the realities of the job of general counsel and that Rule 1.7 offers little practical guidance on how to handle conflicts of interest. Part III then examines recent amendments, case law and administrative decisions, the Sarbanes-Oxley Act, and subsequent Securities and Exchange Commission regulations applicable to attorneys for guidance on what is required for general counsels to maintain independent judgment on behalf of corporate clients. This part also asserts that Sarbanes-Oxley now mandates that general counsels serve as the legal gatekeepers to public companies, resulting in a greater need for general counsels to give independent advice to clients.

Finally, Part IV of this article concludes that, in addition to the recommendations of the American Bar Association Corporate Governance Resolution,[20] to ensure independent judgment of the general counsel, Boards of public corporations should (1) determine the compensation, including bonus, of the general counsel; (2) compensate and reward the general counsel for managing the legal affairs of the company and not for reaching financial performance goals; and, (3) eliminate stock options from total compensation.

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20. ABA TASK FORCE ON CORP. RESPONSIBILITY, FINAL REPORT OF THE AMERICAN BAR ASSOCIATION TASK FORCE ON CORP. RESPONSIBILITY (Mar. 31, 2003) [hereinafter *Final Report*], *available at* http://www.abanet.org/buslaw/corporateresponsibility/final_report.pdf.

II. THE ROLE OF THE GENERAL COUNSEL AND COMPENSATION

A. THE GENERAL COUNSEL'S JOB

As in-house legal departments have grown, so have the duties of the general counsel.[21] The job of the general counsel is to serve as advisor to senior management and the board of directors.[22] He or she is also CLO and department head for the corporate legal department, transactional attorney responsible for completion of business deals, and as legal gatekeeper for the corporation's public constituencies, serves as the corporate secretary.[23]

1. *Executive Officer and Department Head*

The general counsel or CLO is legal advisor to the executive officers, a key member of executive management, and in most companies, reports directly to the chief executive officer.[24] Many general counsels also hold the title of executive vice president.[25] The general counsel usually has a close relationship with the chief executive officer and other members of senior management, particularly the chief financial officer.[26]

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21. *See* Carl D. Liggio, *The Role of the General Counsel: Perspective: The Changing Role of Corporate Counsel*, 46 EMORY L.J. 1201, 1201-03 (1997) (chronicling the changing position of corporate counsel); Milton C. Regan, Jr., *Professional Responsibility and the Corporate Lawyer*, 13 GEO. J. LEGAL ETHICS 197 (2000) (discussing the growing complexity of corporations and the subsequent demands on the general counsel); Sally R. Weaver, *The Role of the General Counsel: Perspective: Ethical Dilemmas of Corporate Counsel: A Structural and Contextual Analysis*, 46 EMORY L.J. 1023, 1027 (1997) (listing possible non-legal positions that corporate counsel may simultaneously hold).

22. *See generally* J. RANDOLPH AYRE, CORPORATE LEGAL DEPARTMENTS: STRATEGIES FOR THE 1990'S (2d ed., 1990) (providing insight into managing corporate legal departments); Randolph C. Park, *Ethical Challenges: The Dual Role of Attorney-Employee as Inside Corporate Counsel*, 22 HAMLINE L. REV. 783, 790 (1999) (explaining difficulties faced by general counsels because of this or her position as employee of and attorney to the corporation).

23. *See generally* Ayre, *supra* note 22, at 59-65 (describing the organization of a corporate legal staff); AM. CORP. COUNSEL ASS'N, SURVEY OF CEO'S: IN-HOUSE COUNSEL FOR THE 21ST CENTURY 1, 2 (May 2001) [hereinafter *In-House Counsel Survey*] *available at* http://www.acca.com/Surveys/CEO/CEOReport.pdf (surveying CEO's expectations of in-house counsel); AM. SOCIETY OF CORP. SECRETARIES, RESPONSIBILITIES OF THE CORP. SECRETARY'S OFFICE, 1, 8 (2001), *available at* http://www.ascs.org/toc28.shtml (listing the responsibilities and personal attributes of the successful corporate secretary).

24. *In-House Counsel Survey*, *supra* note 23, at 3; Liggio, *supra* note 21, at 1208.

25. Weaver, *supra* note 21, at 1027, 1035; *In-House Counsel Survey*, *supra* note 23, at 1.

26. *See generally* Weaver, *supra* note 21, at 1028 (discussing the various evolving challenged and ethical obligations of the corporate counsel); Liggio, *supra* note 21, at 1208-09, 1211 (stating that the close relationship between the corporate counsel and his or her client can create misunderstandings as to the counsel's role and scope of representation).

The general counsel must also understand the company's business, counsel management, and assess legal risks.[27] Many general counsels also serve on executive management, strategic planning, and business development committees, and some general counsels manage business units.[28] Company management and the board of directors view the general counsel as part of corporate leadership.[29]

The corporate legal department is staffed with lawyers practicing in a variety of specialty areas, and general counsels rely less on outside counsel to handle many legal matters.[30] Companies such as General Electric Co., Citigroup Inc., State Farm Insurance Co., International Business Machines Corp., and General Motors Corp., each have more than one hundred in-house lawyers.[31] The hierarchy of large corporate law departments (over twenty-five attorneys) typically consists of the CLO/general counsel, assistant or deputy chief legal officer, division or group counsel, managing attorney, senior attorney, and attorneys or staff attorneys.[32] Corporate legal departments work on matters such as litigation, employment, environmental, real estate, intellectual property, mergers and acquisitions, commercial, and general corporate issues.[33] The general counsel and his or her staff practice preventive law and are proactive in assisting clients with assessment of legal risks and in making decisions on how to handle legal risks.[34]

2. *Transactional Attorney*

The general counsel is often a transactional attorney working with his or her staff and outside counsel to meet corporate clients' business goals.[35] As the lead corporate attorney, the general counsel assists clients in completing business transactions to avoid or minimize legal risks.[36] He or

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27. MODEL RULES OF PROF'L CONDUCT 2.1 (2003); Liggio, *supra* note 21, at 1208-09.

28. Liggio, *supra* note 21, at 1209-10.

29. Weaver, *supra* note 21, at 1027; Liggio *supra* note 21, at 1211-13.

30. Liggio, *supra* note 21, at 1205-06; Susan Hacket, *The Future Structure and Regulation of Law Practice: Inside Out: An Examination of Demographic Trends of the In-House Profession*, 44 ARIZ. L. REV. 609, 611-12 (2002).

31. *Kilpatrick & Lockhart LLP 10th Annual Survey, The 200 Largest Legal Departments*, 13 CORP. LEGAL TIMES 1, 38 (June 2003) [hereinafter *10th Annual Survey*], *available at* http://www.cltmag.com/ editorial/surveys/03-Jun.pdf.

32. Ayre, *supra* note 22, at 19-20.

33. *See* Liggio, *supra* note 21, at 1206-07 (outlining the shift in matters handled by corporate legal departments, specifically mentioning litigation as handled increasingly by in-house counsel).

34. *Id.* at 1210

35. *Id.* at 1206. *See also In-House Counsel Survey*, *supra* note 23, at 1 (describing survey results indicating that in-house corporate counsel "understands the business" better than an outside lawyer).

36. Liggio, *supra* note 21, at 1208.

she negotiates and structures the business and legal framework for large corporate deals.[37] The general counsel reviews SEC disclosure requirements and verifies corporate compliance with various regulations applicable to the corporation.[38] Senior management looks to the general counsel not only to complete the transactions, but also to "find a way" notwithstanding legal challenges.[39]

3. *Gatekeeper*

Though the term gatekeeper is generally ascribed to external auditors, the general counsel is viewed as an internal corporate gatekeeper for legal compliance.[40] The general counsel advises the board of directors and senior management on the legal risks of and compliance with securities laws.[41] He or she conducts internal investigations into allegations of corporate fraud or violations of law by corporate agents, and reports findings to executive management.[42]

4. *Corporate Secretary*

In many corporations, in addition to managing the legal affairs of the corporation, the general counsel is the corporate secretary and is responsible for corporate governance.[43] As corporate secretary, the general counsel maintains corporate records, obtains board approval for certain corporate actions and plans, distributes documents for board meetings, and takes the minutes of board and committee meetings.[44] The general counsel must be knowledgeable about securities laws, reporting requirements for executive officers, and corporate governance requirements of applicable listing agencies.[45]

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37. Watkins, *supra* note 19, at 545-46.

38. Liggio, *supra* note 21, at 1205-06.

39. *Id.* at 1209; Weaver, *supra* note 21, at 1027.

40. Beck, *supra* note 11, at 882; Coffee, *supra* note 19, at 1405.

41. Liggio, *supra* note 21, at 1205-06.

42. *Final Report*, *supra* note 20, at 20.

43. *See Kilpatrick & Lockhart LLP 8th Annual Survey, The 200 Largest U.S. Law Departments*, CORP. LEGAL TIMES (Aug. 2001) [hereinafter *8th Annual Survey*], *available at* http://www.cltmag.com/editorial/surveys/01-Aug.pdf.

44. *Id.*

45. *Huron Consulting Group LLC: 14th Annual Survey of General Counsel*, CORP. LEGAL TIMES (July 2003) [hereinafter *14th Annual Survey*], *available at* http://www.cltmag.com/editorial/surveys/03-Jul.pdf.

B. GENERAL COUNSEL'S COMPENSATION

1. *Salary and Bonuses*

The chief executive officer handles general counsels' salaries and performance evaluations.[46] Compensation for the CLO of public companies has steadily increased over the years.[47] Compensation packages for general counsels, including base salaries, bonuses, and equity compensation are competitive.[48] For 2002, survey data indicates salaries for the one hundred highest paid general counsels ranged from $293,808 to $1,350,000.[49] Total cash compensation for them ranged from $371,667 to $3,930,000.[50]

2. *Stock Options*

Stock options have become an important way for corporate boards to compensate senior management.[51] A stock option is the right to purchase shares of a stock in the future at a fixed price.[52] Stock options are one form of equity compensation and are favored by corporate boards primarily for corporate tax treatment.[53] However, stock options are granted as incentive for management performance, alignment of management interests with those of shareholders, and retention of skilled executives.[54] One goal of stock option grants is to align the interests of executive management with

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46. *10th Annual Survey*, *supra* note 31; Hackett, *supra* note 30, at 612.

47. Weaver, *supra* note 21,at 1031; Liggio, *supra* note 21, at 1207.

48. *GC Compensation Survey*, CORP. COUNSEL (Aug. 2003) [hereinafter *GC Compensation*], *available at* http://www.law.com/special/professionals/corp_counsel/2003/gc_compensation_survey.shtml; James Wilber, *Expert Advice: And the Survey Says. . .*, CORP. COUNSEL (Aug. 1, 2003) http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1056139947559; Rosemary Clancy, *Methodology: Behind the Curtain*, CORP. COUNSEL (Aug. 1, 2003) http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1056139941726.

49. *14th Annual Survey*, *supra* note 45; *GC Compensation*, *supra* note 48; 2002 LAW DEPARTMENT COMPENSATION BENCHMARKING SURVEY PARTICIPANT'S EXECUTIVE SUMMARY: SALARY, ALTMAN WEIL, INC. 15 (Oct. 2002) *available at* http://www.altmanweil.com/pdf/2003/LDCBEXEC-SUMMARY.pdf.

50. *14th Annual Survey*, *supra* note 45.

51. *See* Brian J. Hall, *What You Need to Know About Stock Options*, HARV. BUS. REV., Mar.-Apr. 2000, at 93 (explaining that stock options, in terms of total executive compensation, were at that time greater in value than salaries); *see generally* STEVEN BALSAM, AN INTRODUCTION TO EXECUTIVE COMPENSATION (Academic Press 2002).

52. Balsam, *supra* note 51, at 131-32.

53. Eric L. Johnson, Note: *Waste Not, Want Not: An Analysis of Stock Option Plans, Executive Compensation, and the Proper Standard of Waste*, 26 J. CORP. L. 145, 147-48 (2000).

54. Balsam, *supra* note 51, at 139-40.

those of shareholders.[55] The result of management and shareholder goal alignment is that executives work as a team with common goals for the profitability of the company.[56]

During the 1990s, large stock option grants created enormous wealth among executives.[57] Executives profited from the exercise of stock options often when the financial status of the company was in jeopardy. [58] General counsels also attained personal wealth from stock options comparable to that of senior executives within the company. [59]

Equity compensation, particularly stock option grants, has become part of the overall compensation package of general counsels.[60] From 2002 to 2003, stock option grants ranged from $803,134 to $1,780,800 and exercisable stock option values ranged from $2,328,924 to $13,884,923 for the top one hundred general counsels.[61] Though current market conditions

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55. Rajesh Aggarwal, *Executive Compensation and Corporate* Controversy, 27 VT. L. REV. 849, 850 (2003); Joann S. Lublin, *Executive Pay: Why the Get-Rich-Quick Days May Be* Over, WALL ST. J., April 14, 2003, at R1.

56. Balsam, *supra* note 51, at 140-41, 289.

57. *See* Eriq Gardner, *Bottoms Up*, CORP. COUNSEL (Aug. 1, 2003), http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1058416383413 (discussing the increase in general counsels' salaries in the last decade); Wilber, *supra* note 48 (discussing the rise in general counsels' salaries as compared to rank and file corporate legal department attorneys); Clancy, *supra* note 48 (mentioning which general counsels have stayed on the most-compensated list and which have not); *Spotlight on the Winners' Circle*, CORP. COUNSEL (July 1, 2004), http://www.corpcounsel.com/other/3rd_party/GCProfiles.shtml (listing large stock options granted to various general counsels); *GC Compensation*, *supra* note 48 (listing the actual salaries of the top one hundred corporate general counsels); Press Release, Altman Weil, Inc., *Corporate Belt-Tightening Reflected in Law Department Comp, New Survey Reports* (Nov. 11, 2003), *available at* http://www.altmanweil.com/news/release.cfm?PRID=36 (on file with author) (comparing general counsel compensation with the same data from the previous year).

58. *See Weathering the Storm*, CORP. COUNSEL (July 19, 2002), available at http://www.law.com/jsp/article.jsp?id=1024079009963 (stating that beginning in 2001, many general counsels "cashed in on" their stock options); Michael C. Dorf, *Conflicts of Interest Aren't All Bad: Lessons From the Corporate Accounting Scandals and Beyond*, FINDLAW (July 24, 2002), http://writ.corporate.findlaw.com/dorf/20020724.html (stating that many corporate managers cashed out their stock before the accounting falsities their companies were engaged in came to light); Ashby Jones, *Stock Options: Staying Afloat*, CORP. COUNSEL (Aug. 1, 2003), *available at* http://www.law.com/jsp/cc/pubarticleCC.jsp?id=1056139947190 (explaining that not many general counsels continued to cash out their stock options because of the "miserable" stock market); Steven Andersen, *Reality Check*, CORP. LEGAL TIMES (Mar. 2002), *available at* http://www.cltmag.com/editorial/surves/march02.cfm (explaining that stock options as compensation "went out of style in 2001," which was the beginning of many recent corporate scandals); Dan Lee, *Insiders: EBay Counsel Gains $1.4 Million in Sale* (March 3, 2003), *available at* http://www.siliconvalley.com/mld/siliconvalley/business/columnists/jmsv/5304458.htm (discussing how senior executives at EBay profited more than $198 million from cashing out stock options beginning in March 2002).

59. *See GC Compensation*, *supra* note 48 (listing the salaries and total compensation for the top one hundred general counsels in 2002 and 2003).

60. *Id.*

61. *Id.*

have devalued some stock options,[62] through 1999 highly compensated general counsels received more than $50 million by exercising stock options.[63] For example, in 2002, the general counsel of a public communications company took home nearly $6 million in stock option grants,[64] and a general counsel of a beverage distributor received $9 million in stock options.[65]

C. CORPORATE MALFEASANCE AND ATTORNEY MISCONDUCT

Following the corporate fraud scandals involving Enron, Worldcom and others, Congress passed the Sarbanes-Oxley Act.[66] Sarbanes-Oxley was designed to implement reforms in accounting and promote further transparency in corporate disclosures.[67] Corporate misconduct was blamed on the failure of outside auditors and on market analysts' focus on short-term financial goals.[68] Further, corporate executives were accused of focusing on short-term financial performance to increase personal financial gain, rather than on the long-term interests of the shareholders. Stock options were viewed as contributing to a short-term focus and fostering corporate cultures of greed.[69]

In March 2002, the ABA appointed the Cheek Task Force ("CTF") in an effort to devise rules to address the public perception that lawyers failed to meet professional responsibility obligations to corporate clients arising out of the Enron scandal.[70] CTF examined the "systemic issues related to corporate responsibility."[71] This included examining the roles of lawyers, executives, and others in the context of "checks and balances" for

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62. *See* Jones, *supra* note 58 (discussing the decreasing favor of stock options as part of general counsel compensation).

63. *Id.*

64. Eric Gardner, *William Barr: Verizon Communications, Inc.*, CORP. COUNSEL (Aug. 1, 2003), *available at* http://www.corpcounsel.com/other/3rd_party/GCProfiles.shtml.

65. Jones, *supra* note 58.

66. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (codified as amended in scattered sections of 15 U.S.C.); *See Corporate Responsibility*, http://www.whitehouse.gov/infocus/corporateresponsibility (last visited July 21, 2005) (outlining generally the Bush Administration's response to recent corporate scandals, including signing the Sarbanes Oxley Act into law).

67. *Id.*

68. Coffee, *supra* note 7, at 1408.

69. *See* FINDINGS AND RECOMMENDATIONS, COMMISSION ON PUBLIC TRUST AND PRIVATE ENTERPRISE, ISBN No. 0-8237-0788-1, at 5-6 (2003), *available at* http://www.conference-board.org/pdf_free/758.pdf (criticizing the executive use of stock options as compensation).

70. *See* ABA TASK FORCE ON CORPORATE RESPONSIBILITY, PRELIMINARY REPORT OF THE AMERICAN BAR ASSOCIATION TASK FORCE ON CORPORATE RESPONSIBILITY [hereinafter *Preliminary Report*] (July 16, 2002), 58 BUS. LAW. 189, 189 (Nov. 2002) (describing the mission and purpose of the task force).

71. *Id.* at 191 (quoting Robert Hirshon, President of the American Bar Association).

maintaining corporate integrity in public companies.[72] CTF issued its Preliminary Report in July 2002, and its Final Report in March 2003. Both reports proposed amendments to the Model Rules of Professional Conduct Rule 1.6 (Confidentiality of Information), Rule 1.13 (Organization as Client), and recommended the addition of a Corporate Governance Resolution.[73] CTF did not recommend amendments to Model Rule 1.7 (Conflict of Interests: Current Clients).[74] However, in its Preliminary Report, CTF recommended further review of the impact of stock ownership in client companies on attorney independent judgment and conflicts of interest.[75]

In August 2003, the ABA House of Delegates voted to accept the changes to the Model Rules recommended by the Cheek Task Force.[76] Though the proposed amendments to the Model Rules provided improved guidance on revealing client confidences and the organization as client,[77] the current Model Rules provide less clarity on the application of Model Rule 1.7(b) (Conflicts of Interest: Current Clients) to the general counsel's obligation of independent legal advice.[78]

III. ATTORNEY INDEPENDENT JUDGMENT—WHAT IS REQUIRED?

A. MODEL RULES OF PROFESSIONAL CONDUCT

With the majority of states adopting professional responsibility rules consistent with the ABA Model Rules of Professional Conduct,[79] a review of model rules applicable to attorneys representing the organization as client and conflicts of interest sets the groundwork for understanding the general counsel's obligation of independent judgment to corporate clients.

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72. *Id.* at 189.

73. *Final Report*, *supra* note 20, at 31; *Preliminary Report*, *supra* note 70, at 203-06, 209.

74. *Final Report*, *supra* note 20, at 31; *Preliminary Report*, *supra* note 70, at 212-13.

75. *Final Report*, *supra* note 20, at 31; *Preliminary Report*, *supra* note 70, at 212-13.

76. *See* Press Release, American Bar Association, *ABA Corporate Responsibility Task Force Urges New Corporate Governance Policies and Lawyer Ethics Rules: Addresses Practices and Attitudes that Contributed to Failures* (April 29, 2003), *available at* http://www.abanet.org/media/apr03/ 042903.html (summarizing the design and purpose of the recommendations in the task force's final report).

77. *Final Report*, *supra* note 20, at 41-47; *Preliminary Report*, *supra* note 70, at 203-04.

78. *Final Report*, *supra* note 20, at 41-47; *Preliminary Report*, *supra* note 70, at 203-04.

79. MODEL RULES OF PROF'L CONDUCT, Preface, at vii (2004); Larry P. Scriggins, *Legal Ethics, Confidentiality, and the Organizational Client*, 58 BUS. LAW. 123, 128 (2002).

1. *Who is the Client? Model Rule 1.13 (Organization as Client)—a Look at the Old and New*

Model Rule 1.13 (Organization as Client) focuses on the lawyers employed by corporate entities.[80] Before its amendment by the Sarbanes-Oxley Act, Model Rule 1.13 provided that the general counsel is to act in the best interest of the corporate entity.[81] In such corporate representation, the general counsel was required to accept the decisions of the authorized corporate agents unless the general counsel knows that the corporate actions may violate the law.[82] When faced with possible violations of law by the client, the general counsel was to seek higher review of the matter within the corporate ranks, and if appropriate, inform the board of directors.[83] If the general counsel was unable to prevent the client from violating the law and there is likely substantial injury to the corporation, the general counsel could have resigned if the client refused to act on the lawyer's advice.[84]

Acknowledging that the previous rule provided very little guidance and mandated no specific action by attorneys, the ABA approved amendments to Model Rule 1.13 to give greater clarity and guidance to corporate attorneys.[85] Model Rule 1.13 has been amended *to require* a corporate lawyer (in-house and outside counsel) to report certain violations of the law by officers or employees to higher organizational authority *unless* the lawyer believes that disclosure would not be in the best interest of the organization.[86]

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80. MODEL RULES OF PROF'L CONDUCT R. 1.13 (2004). *See generally* MODEL CODE OF PROF'L CONDUCT, Canon 5, EC 5-13 (2004); RESTATEMENT OF LAW GOVERNING LAWYERS § 131 (1998).

81. MODEL RULES OF PROF'L CONDUCT R. 1.13 (1983).

82. *Id.*

83. *Id.*

84. *Id.*

85. *Final Report*, *supra* note 20, at 41.

86. MODEL RULE OF PROF'L CONDUCT R. 1.13 (2004) (emphasis added). Model Rule 1.13 now reads (new language is underlined):

> (a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.
>
> (b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. <u>Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law.</u>

2. *Comparing the Old and New*

The old Model Rule 1.13 did not *require* the lawyer report a problem "up the ladder," but instead identified several steps the lawyer "may" take.[87] The Cheek Task Force concluded the old Model Rule gave the lawyer discretion to decide when to take action or do nothing at all, and that the old Rule 1.13 was confusing.[88] The amended Model Rule 1.13 now *requires* the lawyer, if he or she reasonably believes it is in the best interest of the organization, to report matters to the highest authority in the corporation who can act on its behalf.[89] If the lawyer believes he or she is discharged or withdraws as a result of reporting the alleged violation of the law, he or she must proceed, in his or her best judgment, to inform the corporation's highest authority of his or her discharge or withdrawal.[90]

(c) Except as provided in paragraph (d), if

(1) despite the lawyer's efforts in accordance with paragraph (b) the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action or a refusal to act, that is clearly a violation of law, and

(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization, then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer's representation of an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.

(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to paragraphs (b) or (c), or who withdraws under circumstances that require or permit the lawyer to take action under either of those paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal.

(f) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

(g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

B. THE OBLIGATION OF INDEPENDENT JUDGMENT—MODEL RULE 1.7: CONFLICTS OF INTEREST: CURRENT CLIENTS

Model Rule 1.7 requires that a lawyer not represent a client if there is a *significant risk* of a conflict of interest, such that the personal interest of the lawyer has an adverse effect on the client.[91] A lawyer is permitted to represent a client if, notwithstanding the conflict of interest, the lawyer reasonably believes he or she will be able to provide competent representation and the client consents.[92] Allowing attorneys to have equity interests in clients grew out of the contingent fee arrangement in litigation.[93] Those who support allowing lawyers to have equity ownership in clients argue that equity ownership allows start-up companies with very little capital to hire attorneys because law firms are inclined to offer more flexible billing arrangements.[94] Clients benefit because lawyers are willing to offer legal and business advice.[95] Further, equity ownership in clients also potentially increases client loyalty to the firm.[96] Attorneys are encouraged to evaluate all equity investments in clients under Model Rule 1.8(a) to ensure the attorney fees are not excessive.[97]

Though it does not prohibit equity ownership, the commentary to Model Rule 1.7 generally advises it may be "difficult or impossible" for an

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91. MODEL RULE OF PROF'L CONDUCT R. 1.7 (2004). Specifically, Model Rule 1.7 provides:

> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
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> ....
>
> (2) there is a significant risk that the representation of one or more clients will be materially limited...by a personal interest of the lawyer.
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> (b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
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> (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
>
> (2) the representation is not prohibited by law;
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> (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
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> (4) each affected client gives informed consent, confirmed in writing.

92. *Id.*

93. *See e.g.*, Jason M. Klein, *No Fool For a Client: The Finance and Incentives Behind Stock-Based Compensation for Corporate Attorneys*, 1999 COLUM. BUS. L. REV. 329, 334-35 (1999).

94. *Id.* at 340; John S. Dzienkowski & Robert J. Peroni, *The Decline in Lawyer Independence: Lawyer Equity Investments in Clients*, 81 TEX. L. REV. 405, 416-19 (2002).

95. Dzienkowski and Peroni, *supra* note 94, at 430, 433.

96. *Id.* at 432.

97. Klein, *supra* note 93, at 332.

attorney to give independent advice to a client when the lawyer has a personal interest in a transaction.[98] The commentary to Model Rule 1.7 recommends steps the lawyer should take to protect the client.[99] External corporate attorneys should assess whether a transaction is fair and reasonable by ensuring that: (1) the client was not coerced into the transaction; (2) the lawyer gave independent advice to the client; and, (3) the client would have received the same advice from an independent or disinterested lawyer.[100]

The ABA recommends that law firms establish investment policies to minimize the risks of equity investments in clients.[101] Included in such investment policies are procedures to ensure any equity investments in clients are fair, reasonable, and consistent with the requirements under Model Rules 1.7 and 1.8(a) on excessive fees, and that investments in clients are limited.[102] A review of state ethics opinions indicates the majority of state ethic opinions follow the rationale of the ABA and permit external counsel to make or have equity investments in clients provided: that the attorneys take measures to ensure fairness of the transaction to the client, that the client has made informed consent, and that the fee is not excessive.[103] The ABA recommends that when equity investment in clients increases the financial dependence of the law firm on a single client, external counsel should withdraw from representation even if the client consents.[104]

The Council of the Section of Litigation, in its Report on the Independent Lawyer (Report on Lawyer Independence),[105] writes "in-house counsel's receipt or ownership of equity-based compensation is not problematic as long as the lawyer reasonably believes that the representation of the client will not be materially limited by the lawyer's own interest."[106] The Report on Lawyer Independence did not recommend against external counsel investments in clients, but encouraged lawyers to

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98. MODEL RULES OF PROF'L CONDUCT R. 1.7(a)(2), R. 1.7 cmt (2004).

99. *Id.*

100. MODEL RULE OF PROF'L CONDUCT 1.7(a)(2); ABA Formal Op. 00-418, 3-4 (2000), *available at* http://www.cobar.org/static/comms/ethics/fo/00-418.html.

101. ABA Formal Op., *supra* note 100, at 2-3.

102. *Id.;* Margaret Colgate Love, *The Revised ABA Model Rules of Professional Conduct: Summary of the Work of Ethics 2000,* 15 GEO. J. LEGAL ETHICS 441, 448-49 (2002).

103. *See* ABA Formal Op., *supra* note 100, at 6.

104. *Id.* at 7.

105. ABA TASK FORCE ON THE INDEPENDENT LAWYER, LAWYERS DOING BUSINESS WITH THEIR CLIENTS: IDENTIFYING AND AVOIDING LEGAL AND ETHICAL DANGERS 56 (2001) [hereinafter *Independent Lawyer Report*], *available at* http://abanet.org/litigation/abareport.pdf.

106. *Id.* at 56; *see also* ABA Formal Op., *supra* note 100, at 6.

be vigilant in searching for potential conflicts of interests and to take steps to avoid any harm to clients.[107]

C. HOW DOES MODEL RULE 1.7 APPLY TO THE GENERAL COUNSEL?

Professional rules interpreting attorney conflicts of interest are premised on protecting the client from undue influence of the attorney.[108] The Model Rule 1.7 Commentary recommends that a lawyer withdraw from representing a client if the lawyer's financial interest in the client leads to the reasonable conclusion that the representation would be adversely affected.[109] Current commentary and ABA guidance on Model Rule 1.7 provide no specific guidelines recommending review of stock option or other equity grants to the general counsel.[110] Moreover, the Model Rules focus on protecting the client from undue influence by the attorney and provide limited direction for the general counsel on how to assess independence.[111]

Stock option ownership in clients by the general counsel raises conflicts of interest issues under Model Rule 1.7(b) (Lawyer Independence).[112] The ABA Formal Opinion on acquiring ownership in clients and the Report on Lawyer Independence both concluded that in-house counsel receipt of equity based compensation such as stock options is not prohibited under Model Rule 1.7(b), provided that the lawyer reasonably believes that the representation will not be materially limited by the lawyer's interests.[113] The Report on Lawyer Independence acknowledged that in-house counsel stock option compensation is not normally the type of transaction contemplated by the Model Rules.[114] The Report then concluded that in-house counsel's receipt of stock options is not a problem provided that the in-house lawyer reasonably believes his or her own interest will not materially impact the client.[115] Determining that most in-house counsel equity compensation is a "small facet of his or her general counsel employment" and that most equity compensation are "small incremental [grants]

107. *Independent Lawyer Report*, *supra* note 105, at 56-58

108. *Id.* at 43.

109. *Id.* at 56; MODEL RULES OF PROF'L CONDUCT R. 1.7 cmts. 4, 10 (2004).

110. *Independent Lawyer Report*, *supra* note 105, at 55-56.

111. *Id.* at 56.

112. *Id.* at 56-57.

113. *Independent Lawyer Report*, *supra* note 105, at 56; ABA Formal Opinion, *supra* note 100, at 5.

114. *Independent Lawyer Report*, *supra* note 105, at 58.

115. *Id.* at 56.

over time" the Report concluded that conflict issues under Rule 1.7 are not normally raised for in-house counsel.[116]

The Report on Lawyer Independence further concluded that equity compensation did not raise issues under Rule 1.8 (Excessive Fees), as equity compensation is part of usual compensation paid to in-house counsel as part of his or her regular employment relationship.[117] The Report also determined that aligning in-house counsel interest with those of shareholders generally did not create adverse interests to clients, and that violation of securities laws by improper trading of corporate stock risks criminal liability by the in-house attorney.[118] However, recommending that each situation be examined on "its unique facts," the Report on Lawyer Independence suggested that a large personal equity interest might raise questions on the in-house lawyer's ability to represent a client if the legal advice might result in a significant financial loss of the lawyer's equity interest.[119] Generally, stock options granted to the general counsel are awarded as part of a corporation's long-term incentive plan.[120] However, when the general counsel is involved in drafting the documents and specific terms of the plan, issues of fairness to the company are raised.[121]

The Cheek Task Force's Preliminary Report recommended further review of executive compensation and potential conflicts of interest issues, writing that:

> the Task Force has...not at this time formulated recommendations on specific policy initiatives relating directly to public company audits, executive compensation and benefit plans, security analysts or employee retirement benefit plans. It is nevertheless the sense of the Task Force that meaningful reforms in these areas are necessary to complement the reforms it is proposing with respect to board of directors and corporate lawyers.... [T]he Task Force also believes that executive compensation practices, including the provisions and accounting for stock options, need to be carefully considered in reviewing reform necessary to enhancing corporate responsibility.[122]

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116. *Id.* at 57-58.

117. *Id.* at 58.

118. *Id.*

119. *Id.* at 57-58.

120. *Independent Lawyer Report*, *supra* note 105, at 58.

121. *Id.* at 57. *See also* Liggio, *supra* note 21, at 1208-09, 1214-16, 1218 (discussing areas of corporate affairs in which in-house counsel is involved and its affect on the company).

122. *Preliminary Report*, *supra* note 70, at 194 n. 9.

Notwithstanding professional rules permitting lawyer equity ownership in clients, courts generally view such transactions under fiduciary principles, and presume such transactions are fraudulent, shifting responsibility to the attorney to demonstrate the fairness of a transaction to the client.[123] Courts look to the appearance of impropriety to assess attorney independent judgment.[124]

D. WHAT DO COURTS AND REGULATORY AGENCIES HAVE TO SAY ON INDEPENDENT JUDGMENT?

A few courts have addressed the issue of lawyer independence and have recognized that loyalty to a superior can influence the independent judgment of in-house counsel. Though not addressing issues of equity ownership, the court in *In re Oracle Systems Securities Litigation*,[125] a derivative settlement action, questioned whether representation of individual defendants and the corporation by its general counsel raises conflict issues because of the subservient loyalty of in-house counsel to the officers of the corporation.[126] The court stressed the importance of avoiding the appearance of impropriety when in-house counsel must advocate positions in support of their superiors.[127]

In *Simms v. Exeter Architectural Products, Inc.*,[128] the court considered whether an attorney's equity ownership in a closely held corporation created a conflict of interest that precluded the attorney from representing the corporation.[129] The former president of Exeter asked to disqualify Exeter's law firm because the firm advised him personally on the matter involved in the litigation, thus creating a conflict of interest.[130] Several of the law firm partners owned equity interest in Exeter.[131] The court did not directly address the attorney client relationship, but specifically considered

123. *See* Nancy J. Moore, *Conflicts of Interest for In-House Counsel: Issues Emerging from the Expanding Role of the Attorney-Employee*, 39 S. TEX. L. REV. 497, 546 (1998) (mentioning that "conflicts of interest are beginning to surface in the public eye, most disturbingly, in the form of legal malpractice and breach of fiduciary duty lawsuits against the lawyers themselves as well as their corporate clients").

124. ABA Formal Op., *supra* note 100, at 6.

125. 829 F. Supp. 1176 (N.D. Cal. 1993).

126. *In re Oracle*, 829 F. Supp. at 1187-88. *See also* Yablonski v. United Mine Workers of Am., 448 F.2d 1175, 1177-78 (D.C. Cir. 1971) (discussing the representation of a union president by the union's general counsel in a civil action for misappropriation of funds).

127. *Id.*

128. 868 F. Supp. 668 (M.D. Pa. 1994).

129. *Simms*, 868 F. Supp. at 675.

130. *Id.*

131. *Id.* at 676.

the equity positions held by several partners in Exeter.[132] The court found that when the attorney is both an advocate for and an owner of an entity, "it appears to be extremely difficult if not impossible for the attorney to give advice as a non-interested party."[133] Concerned about the appearance of impropriety, the court concluded a firm serving as corporate counsel that is also a shareholder should be disqualified from representing Exeter under Rule 1.7(b).[134]

However, determining that stock ownership in the client public corporation did not disqualify the attorney under Model Rule 1.7(b), the court in *Syscon v. United States*[135] stated that suggestions that the lawyers' "concern for the corporate pocketbook" puts independent judgment at risk were unreasonable.[136] The general counsel of Syscon owned stock in the corporation, served on the board of directors, and was also a partner in the law firm representing Syscon in litigation.[137] The government asserted that the independence of the legal advice in the litigation was compromised because of the dual status of the general counsel.[138] The court held that an attorney's stock ownership in the client corporation did not disqualify the firm from representing the client in litigation. [139] Concerned about the policy implications of disqualifying a general counsel who owned stock in his client from representing the client in litigation matters, the court reasoned that if courts were to assume that if stock ownership compromised the judgment of the general counsel, then it would preclude the general counsel from serving as litigation counsel.[140]

Courts are concerned with the appearance of impropriety under Rule 1.7 as it relates to in-house counsel representation of corporate clients.[141] Where equity ownership in a client raises issues of attorney independence, courts will consider the practical and policy implications of precluding in-house attorneys from representing corporate clients due to conflicts of

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132. *Id.* at 676.
133. *Id.*
134. *Id.* at 677.
135. 10 Cl. Ct. 200 (1986).
136. *Syscon*, 10 Cl. Ct. at 202.
137. *Id.* at 201.
138. *Id.*
139. *Id.* at 204.
140. *Id.*
141. *See e.g., id.* at 201-02 (discussing the government's argument on Model Rule 1.7 in the *Syscon* case).

interests.[142] Courts also examine attorney transactions with clients to ensure that the lawyer has not breached a fiduciary duty.[143]

The Securities and Exchange Commission (SEC) has provided no administrative ruling on what external and in-house counsel must do to ensure independent legal advice. There are no SEC administrative rulings on attorney conflict of interest, and the SEC has not addressed the issue of lawyer independence or management influence on attorney independent judgment. However, the SEC has consistently advised attorneys to report client wrongdoing to a higher authority within the corporation and to conduct internal investigations, including following up to ensure compliance.[144]

In *In re Carter,*[145] external corporate attorneys were not sanctioned by the SEC when the attorneys were accused of aiding and abetting a client in repeatedly failing to make required disclosures under securities laws.[146] Although the attorneys were originally sanctioned by an administrative law judge, on appeal, the full Commission held that without clear prior guidance from the SEC on what is "unethical and improper professional conduct," a lawyer should not be disciplined by the SEC.[147] The SEC further stated that "when a lawyer...becomes aware that his client is engaged in a substantial and continuing failure to satisfy...disclosure requirements, his continued participation violates professional standards unless he takes prompt steps to end the client's noncompliance...."[148] The Commission recommended that the attorneys consider resigning or reporting the matter to others in the corporation, including the directors, but did not outline specific actions.[149]

In *In re Gutfruend,*[150] the SEC concluded that the CLO of Salomon Brothers failed to take appropriate measures to prevent his client from violating the law.[151] The SEC also concluded the CLO, after learning of possible criminal conduct, did not do enough to investigate and also suggested that the CLO was obligated to ensure that appropriate steps are

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142. *Syscon*, 10 Cl. Ct. at 201-02.

143. *See* Dzienkowski, *supra* note 94, at 445-48.

144. *See In re Carter*, S.E.C. Release No. 34-17597 [1981 Transfer Binder], Fed. Sec. L. Rep. (CCH), ¶ 82,847, at 84,146 (Feb. 28, 1981) (providing an example of the SEC providing this type of advice).

145. S.E.C. Release No. 34-17597 [1981 Transfer Binder], Fed. Sec. L. Rep. (CCH), ¶ 82,847 (Feb. 28, 1981).

146. *In re Carter*, [1981 Transfer Binder], Fed. Sec. L. Rep. (CCH) at 84, 146.

147. *Id.* at 84,172.

148. *Id.*

149. *Id.*

150. S.E.C. Release No. 34-31554 [1992 Transfer Binder], Fed. Sec. L. Rep (CCH) ¶ 85,067, at 83,597 (Dec. 3, 1992).

151. *In re Gutfreund*, [1992 Transfer Binder], Fed. Sec. L. Rep. (CCH), at 83,609.

taken to rectify known violations of law.[152] The SEC further advised that the CLO should monitor an internal investigation of misconduct to ensure its recommendations are carried out, approach other senior management if management failed to act, and if that failed, approach the board of directors, resign, or disclose misconduct to the SEC.[153]

It is unknown how far the SEC will go to enforce the gatekeeper responsibilities of the general counsel, but it is certain the SEC will look to the general counsel to maintain the integrity of public company disclosures and to serve as the arbiter of independent advice.[154] While the SEC has not addressed the issue of independent judgment by attorneys, armed with a Congressional mandate to regulate the professional ethics obligations of attorneys advising public companies, we are likely to see more enforcement actions against attorneys who fail to reign in clients engaged in misconduct.

E. THE SEC'S RESPONSE TO ATTORNEY MISCONDUCT AND CORPORATE MALFEASANCE: SARBANES-OXLEY § 307 AND SEC IMPLEMENTING REGULATION 17 C.F.R. § 205

Before enactment of the Sarbanes-Oxley Act, the SEC maintained it was not in the business of regulating attorney ethics.[155] In July 2002, stressing the need to restore investor confidence after several corporate scandals shook public markets, Congress passed and the president signed the Sarbanes-Oxley Act into law.[156] The purpose of the act was to restore confidence in public companies through regulation of executives and their advisers, including accountants and lawyers.[157] Section 307 was added to

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152. *Id.*

153. *Id.*

154. *See e.g.*, Beck, *supra* note 11, at 906-07 (discussing the tradition of the legal profession as self-regulating and mentioning the possible shift in that tradition after Sarbanes Oxley); Geraldine Scott Moohr, *An Enron Lesson: The Modest Role of Criminal Law in Preventing Corporate Crime*, 55 FLA. L. REV. 937, 973 (2003) (mentioning the role of lawyers in being required to act as a "gatekeeper" by reporting securities violations after Sarbanes Oxley); William H. Donaldson, Chairman, U.S. Sec. and Exch. Comm., Remarks to the Practising Law Institute, Washington, D.C. (March 5, 2004), *available at* http://www.sec.gov/news/speech/spch030504whd.htm (discussing the need for an independent board of directors, in general).

155. *See* e.g., Letter from David M. Becker, General Counsel, Securities and Exchange Commission, to Richard W. Painter, Professor of Law, University of Illinois (March 28, 2002) (on file with North Carolina Banking Institute).

156. Final Rule: Implementation of Standards of Professional Conduct for Attorneys, SEC Release Nos. 33-8185, 34-47276, IC-25919, File No. S7-45-02 (Aug. 5, 2003) [hereinafter *Final Rule*], *available at* http://sec.gov/rules/final/33-8185.htm.

157. *See* 15 U.S.C.A. § 7211 (a) (2004) (stating that, for example, the purpose of establishing the accounting oversight board under Sarbanes-Oxley was to "protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports"); 15 U.S.C.A. § 7245 (2004) (stating that minimum standards of conduct for attorneys

Sarbanes-Oxley creating a congressional mandate for the SEC to establish rules for attorney professional conduct.[158] Although the ABA lobbied Congress and the SEC insisted that regulation of attorney ethics should be left to state bar rules and state courts, the SEC issued final rules effective in August 2003 governing attorney ethical obligations in reporting client misconduct.[159] The regulations do not specifically mandate that attorneys take certain measures to maintain independent legal advice. However, consistent with state and ABA model rules, the requirements of "up-the-ladder" reporting presume that attorneys will meet professional standards of independence in carrying out obligations to investigate and report material violations of law as mandated by section 307 of Sarbanes-Oxley.[160]

The rules adopted by the SEC detail reporting requirements. First, an attorney must report evidence of a material violation, determined according to an objective standard, "up-the-ladder" to the chief legal counsel or the chief executive officer of the company or the equivalent.[161] Second, if the chief legal counsel or the chief executive officer of the company does not respond appropriately to the evidence, the attorney is required to report the evidence to the audit committee, another committee of independent directors, or the full board of directors.[162] Third, attorneys that provide legal services to an issuer who have an attorney-client relationship with the issuer, and who have notice that documents they are preparing or assisting in preparing will be filed with or submitted to the SEC are covered by the Rules.[163] Fourth, an attorney may satisfy the reporting obligation by reporting evidence of a material violation to a "qualified legal compliance committee (QLCC)," as an alternative procedure for reporting evidence of a material violation.[164] Such a QLCC would consist of at least one member of the issuer's audit committee or an equivalent committee of independent directors, and two or more independent board members, and would have the responsibility, among other things, to recommend that an issuer implement an appropriate response to evidence of a material violation.[165] Fifth, an attorney may reveal confidential information related to his or her representation without the consent of an issuer client to the extent the

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practicing before the S.E.C. shall be established "in the public interest and for the protection of investors").

158. *Final Rule*, *supra* note 156; 17 C.F.R § 205.1 (2004).

159. *Final Rule*, *supra* note 156.

160. 17 C.F.R. § 205.1.

161. 17 C.F.R. § 205.3 (b)(1) (2004).

162. *Id.* § 205.3 (b)(3)(i)-(iii).

163. *Id.* § 205.3 (b)(4)-(10).

164. *Id.* § 205.3 (b)(6)(i)(B).

165. *Id.* § 205.3 (c)(1)-(2).

attorney reasonably believes necessary (1) to prevent the issuer from committing a material violation likely to cause substantial financial injury to the financial interests or property of the issuer or investors; (2) to prevent the issuer from committing an illegal act; or, (3) to rectify the consequences of a material violation or illegal act in which the attorney's services have been used. [166]

Sixth, the Rules modify the definition of the term "evidence of a material violation," which defines the trigger for an attorney's obligation to report "up-the-ladder" within an issuer.[167] The revised definition confirms that the SEC intends an objective rather than a subjective triggering standard, involving credible evidence based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur.[168] Finally, the Rules state that in the event the Rules conflict with state law, the Rules will govern, but will not preempt the ability of a state to impose more rigorous obligations on attorneys that are not inconsistent with the Rules.[169] The Rules also affirmatively state that no private cause of action is created and that authority to enforce compliance with the Rules is vested exclusively with the SEC.[170]

The SEC regulations do not replace state or other jurisdictional professional rules that are more restrictive, provided such rules do not conflict with SEC requirements.[171] The regulations are designed to increase investor confidence in public companies by "ensuring that attorneys who represent issuers report up the corporate ladder evidence of material violations by their officers and employees."[172]

The congressional mandate to regulate the professional conduct of attorneys practicing before the SEC encompasses in-house and external counsel who do not specifically practice in the securities law area, and places the responsibility for reporting material violations of law "up the ladder" within the corporation firmly in the hands of in-house counsel—the general counsel is gatekeeper for the public trust.[173] Compliance with Sarbanes-Oxley regulations presumes the CLO is acting in the best interests

166. *Id.* § 205.3 (d).
167. 17 C.F.R. § 205.2 (b) (2004).
168. *Id.* § 205.2 (b)(1)-(3).
169. 17 C.F.R. § 205.4 (2004).
170. 17 C.F.R. § 205.7 (2004).
171. 17 C.F.R. § 205.1.
172. *Final Rule*, *supra* note 156.
173. Coffee, *supra* note 18, at 1295-96, 1301

of the company.[174] In instances where it is believed the CLO has not taken appropriate action to stop or prevent corporate fraud or other material violations of law, other in-house attorneys are now required to receive the results of investigations and continue to report the matter "up the ladder" within the corporation.[175] If it is reasonably believed allegations of material violations of law have not been investigated, then the attorney must report allegations directly to the board of directors.[176] Such rules are designed to allow in-house attorneys to report evidence of material violations of law directly to the board in the event the reporting attorney believes the CLO is unwilling to conduct a thorough investigation.[177]

F. GATEKEEPER: THE IMPACT OF SARBANES-OXLEY

Enactment of the Sarbanes-Oxley Act further obligates the chief legal officer or general counsel of a public company to take certain mandatory measures to prevent corporate malfeasance.[178] Passage of Sarbanes-Oxley and the related SEC implementing regulations make clear that the general counsel is required to serve as the legal gatekeeper for public companies.[179] Independence is paramount to the general counsel in successfully serving the gatekeeper function.[180] The integrity of public disclosures are dependent on the perception that the general counsel's loyalty to superiors will not influence his or her independent advice to executive management or the board of directors.[181] The general counsel should discuss with independent board members not only possible corporate management illegal conduct, but any concerns of undue influence over in-house counsel.[182]

The mandates of "up the ladder" reporting potential fraudulent conduct by corporate agents requires corporate attorney and practicing in-house and external counsel to be diligent to ensure the best interest of the corporation is served in business transactions.[183] Sarbanes-Oxley regulations require members of the general counsel's staff to continue to report allegations of

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174. *Id.* at 1311-12.
175. 17 C.F.R. § 205.3(b)(3).
176. *Id.*
177. *Id.* at § 205.3 (b)(4).
178. Coffee, *supra* note 18, at 1302-07.
179. *Id.*
180. *Id.* at 1311.
181. *See id.* (explaining that when a law firm holds a substantial portion of the corporate client's equity, they will be biased and a poor monitor).
182. *Final Report, supra* note 20, at 23-24; *Preliminary Report, supra* note 70, at 205.
183. *Preliminary Report, supra* note 70, at 201-05.

corporate misconduct "up the ladder" if the attorney believes the general counsel has not taken appropriate action.[184]

The general counsel is the transactional attorney and corporate gatekeeper. Compensating general counsels with base salaries and bonuses for managing the legal affairs of the company is appropriate. Rewarding the general counsel for "thinking like an owner" is not. The chief legal officer represents the best interests of the corporation and there should be no appearance of impropriety regarding independent advice.

Compliance with Sarbanes-Oxley requirements increases the legal and professional responsibilities of the general counsel to serve the best interests of the corporation and to see that financial goals are attained lawfully.[185] The general counsel should be rewarded for outstanding legal work, including compliance with ethical obligations of the SEC and the state bar. Salary and bonuses in recognition of outstanding performance are appropriate. Stock options are rewards for reaching financial performance goals. Millions of dollars in stock option wealth not only raises questions about where the general loyalties lie, but can compromise the general counsel's judgment in the same way other corporate executives are compromised by the lure of stock option wealth.[186]

IV. GUIDANCE FOR THE GENERAL COUNSEL

A. TAKEN ALTOGETHER, WHAT IS REQUIRED FOR INDEPENDENT JUDGMENT?

The general counsel is to act in the best interests of the corporation, not in the best interests of the general counsel's superiors or his or her personal interests. The Model Rules require the general counsel to assess potential client conflicts of interest between himself or herself and the corporation, and ensure that any of the general counsel's adverse interests do not harm the client.[187] The general counsel must make certain the corporate client understands the nature of the conflict, receives independent advice concerning waiving the conflict, and if a stock option grant represents a significant personal asset of the general counsel, he or she must determine if

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184. 17 C.F.R. § 205.3 (b)(3).

185. *Preliminary Report*, *supra* note 20, at 193-99; *Findings and Recommendations*, *supra* note 69, at 7.

186. *See generally* Keith R. Fisher, *The Higher Calling: Regulation of Post-Enron Lawyers*, 37 U. MICH. J.L. REFORM 1017, 1018 (Summer 2004) (discussing "post-Enron" ethical obligations of attorneys and asserting that lawyers and their representative bar association's promulgation may be "motivated by politics and self-interest").

187. MODEL RULES OF PROF'L CONDUCT R. 1.7 (b) (2004).

the compensation is excessive and withdraw from representation notwithstanding the conflict waiver.[188] The general counsel must review any equity compensation through the lens of impropriety and fairness to the corporate entity. The general counsel must report allegations of material violations of law by corporate agents "up the ladder" and the general counsel's failure to investigate a report of material violations risks further "up the ladder" reports of non-action.[189] Finally, the general counsel is to resign when faced with recalcitrant clients and if necessary, report the reason for the withdrawal to the board of directors or outside regulatory authorities.[190] Is this practical advice for the general counsel?

B. WHAT'S WRONG WITH STOCK OPTIONS?

Believing stock options should be eliminated from executive compensation, Paul Volcker[191] states that stock options "are subject to abuse and temptation in a way that's almost irrefutable."[192] It is believed that stock options lead executives to focus on short-term financial results that positively affect personal financial wealth and lead executives to manipulate or produce fraudulent financial statements.[193] Executives faced with the loss of millions of dollars in personal assets will choose to protect their personal wealth rather than do what is best for the corporate entity.[194] Similarly, when stock options comprise the general counsel's largest personal financial asset and the ability to continue to receive stock options hinges on conforming to the demands of the chief executive officer, it is not unreasonable to assume that the independent judgment of the general counsel might be adversely affected.[195]

188. *See id.*; MODEL RULES OF PROF'L CONDUCT R. 1.7, cmts. 3-4, 17-18.

189. MODEL RULES OF PROF'L CONDUCT R. 1.7, cmt. 35.

190. *Id.*

191. *See* The Trilateral Commission: Paul A. Volcker, http://www.trilateral.org/membship/bios/pv.htm (last visited Mar. 7, 2005) (providing the biographical information for Paul Volcker). Paul A. Volcker is former North American Chairman of The Trilateral Commission. He is former Chairman of Wolfensohn & Co., Inc., as well as Professor Emeritus of International Economic Policy at Princeton University. Mr. Volcker served as Chairman of the Board of Governors of the U.S. Federal Reserve System, Commission on Public Trust and Private Enterprise. *Id.*

192. Cassidy, *supra* note 8, at 15 (quoting Paul A. Volccker).

193. *Id.* at 6-13; Wallace, *supra* note 11, at 586-87.

194. Cassidy, *supra* note 8, at 6-13; Wallace, *supra* note 11, at 586-87; *Final Report*, *supra* note 20, at 11.

195. Christine Hurt, *Counselor, Gatekeeper, Shareholder, Thief: Why Attorneys Who Invest in Their Clients in a Post-Enron World Are "Selling Out," Not "Buying In"*, 64 OHIO ST. L.J. 897, 898-901 (2003).

C. WHY ARE STOCK OPTIONS FOR THE GENERAL COUNSEL A PROBLEM?

Because the chief executive and his or her senior management team all were getting rich from stock options or other equity compensation, many companies tolerated corporate cultures of avarice[196] and few executives were willing to raise questions about questionable financial statements.[197] The Cheek Task Force ("CTF") cited the increases in stock price, management desires to meet Wall Street expectations, and competitive pressures on executive compensation as factors contributing to corporate environments where independent advice can be difficult to render. [198] CTF concluded that

> [a]ided by dramatic stock price growth, equity-based executive compensation—particularly in the form of stock options—as a means intended to align the interests of managers and shareholders became increasingly prevalent and lucrative. There were unanticipated consequences. Executive officers were endowed with powerful personal incentives to meet near term Wall Street earnings expectations and to avoid any negative impact upon current stock market prices. Directors faced significant pressures to produce executive compensation and benefit packages that were attractive in an ever-escalating executive compensation marketplace. The reasonableness of compensation and its structure, as well as the motivations being created, may not have received sufficient independent consideration. [199]

What makes the application of the professional rules of conduct for the general counsel different from those applicable to counsel in private practice or outside counsel? The answer is twofold: the chief executive officer is the direct superior of the general counsel responsible for performance reviews and compensation decisions, and the management pressure on the general counsel to fit into the corporate culture and advance within the corporate ranks. [200]

At the Randolph W. Thrower Symposium, Sally Weaver remarked:

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196. Cassidy, *supra* note 8, at 7-8.

197. *Id.* at 15.

198. *Preliminary Report*, *supra* note 70, at 192.

199. *Id.* at 193.

200. *Final Report*, *supra* note 20, at 14-15; Raphael Grunfeld, *Getting Caught in the Middle: Enron Experience Shows How In-House Lawyers Can Be an Unprotected Species*, N.Y. L. J. (May 6, 2002), *available at* http://www.clm.com/pubs/pub-11676731. html.

> Corporate counsel[s]...are generally reluctant to acknowledge, at least publicly, any distinction between themselves and lawyers in private practice. Corporate counsel[s] have recently realized a significant increase in number and growth in prestige. They clearly remember, however, a time in the not so-distant past when many of their colleagues in private practice relegated them to the status of second-class citizens. They also fear that the development of different ethical rules, for or the different application of existing ethical rules to, corporate counsel could relegate them again to that second-class status. Corporate counsels have joined in a public incantation of sameness.... Corporate counsel[s] actually do practice law in an environment that differs dramatically from that of their colleagues in private practice. That difference means that the existing rules of professional conduct, at least as historically interpreted, may provide inadequate guidance to corporate counsel.[201]

The Model Rules' recommendation that in-house counsels resign or withdraw from representation when faced with recalcitrant clients is not helpful to corporate clients. The Model Rules ignore the financial dependence of the general counsel on a single client, the pressure on the general counsel to fit into the corporate culture, and the demands of chief executive officers on general counsels to "find a way."[202]

D. THE ROLE OF THE GENERAL COUNSEL, INDEPENDENCE AND WITHDRAWAL FROM REPRESENTATION

The general counsel's job as transactional attorney and gatekeeper demands that the general counsel is independent enough to tell senior management, the chief executive officer, or the board of directors what they may not want to hear.[203] If management insists on causing "substantial financial harm" to the corporation or committing "material violations of law" contrary to the legal advice of the general counsel, lawyers must take action to protect the interests of the corporation.[204]

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201. Weaver, *supra* note 21, at 1031.

202. *Id.* at 1027.

203. *Id.* at 1040-51; *see also* Balla v. Gabmro, Inc., 584 N.E.2d 104 (Ill. 1991) (describing a suit brought by in-house counsel for retaliatory discharge after the attorney told his employer that he would do whatever was necessary to stop employer's sale of defective product).

204. Weaver, *supra* note 21, at 1040-52; Veasey, *supra* note 12, at 12-14.

Financial dependence on a single client and the significant financial wealth provided by stock options can compromise independent judgment.[205] Granting stock option incentive compensation to the general counsel to align his or her financial goals with those of executive management ignores the duty of the general counsel to represent the corporate entity, not its agents. Once the financial interests of the general counsel are aligned with executive management, his or her ability to rein in corporate misconduct is impaired.[206]

Current professional rules suggest that the general counsel, like his external brethren, should withdraw when management insists on breaching fiduciary duties or engaging in fraudulent financial transactions, and when the general counsel reasonably believes his or her independent judgment is impaired. Resigning is not always a viable option for general counsels.[207] While the financial costs to external counsels are significant, external counsels have other clients within the firm in the event withdrawal is required.[208] The career costs to a resigning general counsel can be financially devastating and future career prospects can be difficult.[209] General counsels can and should embrace attorney professional conduct rules and corporate governance practices designed to ensure corporate counsel independence from management. While resigning will distance the general counsel from the acts of the intransigent client, resignation does not restore the harm to the corporation whose general counsel independent judgment is compromised.[210]

A general counsel's option grants no longer appear to be a small part of overall compensation, and the magnitude of equity wealth for general counsels raises conflict issues under Model Rules 1.7 and 1.8(a).[211] On what basis is the general counsel to assess whether his or her stock option compensation is excessive under Model Rule 1.8(a)? There is very little

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205. *See* Thomas D. Morgan, *Toward a New Perspective on Legal Ethics*, Remarks at the Keck Lecture on Ethics and Professional Responsibility (Feb. 13, 200), (on file with author) *available at* http://www.abf-sociolegal.org/keck lecture.html (last visited Oct. 7. 2003) While salary and bonus compensation for the general counsel can be high, stock options present a unique circumstance due to the potential for large gain and the ability of executives to manipulate corporate financial results to keep the stock price high in order for corporate executives to reap a gain. *Id.*

206. *See* Daly, *supra* note 13, at 1099-1100 (explaining that a lawyer who is dependent on a single client for his or her livelihood cannot provide independent advice of the same caliber as outside counsel).

207. *Moore, supra* note 123, at 521-23.

208. Kim, *supra* note 14, at 204.

209. Wallace, *supra* note 11, at 611-12.

210. Kim, *supra* note 14, at 204-07.

211. *Independent Lawyer Report*, *supra* note 105, at 58; Lee, *supra* note 58.

guidance to answer this question because the Model Rules focus on protecting the client.[212]

Expressing concern over the ability of general counsels to render independent advice, the Cheek Task Force wrote that the general counsel may succumb to the pressure to "advance with the corporate executive structure...[and may] to seek to please the corporate officials with whom they deal rather than to focus on the long-term interest of the client...."[213] Addressing these concerns, the Cheek Task Force recommended and the ABA endorsed corporate governance practices guidelines.[214] The Corporate Governance Resolution identified twelve steps for corporate boards and their attorneys.[215] The guidelines related to attorney conduct state that:

> ...
>
> 4. Providing information and analysis necessary for the directors to discharge their oversight responsibilities, particularly as they relate to legal compliance matters, requires the active involvement of general counsel for the public corporation.
>
> 5. A lawyer representing a public corporation shall serve the interests of the entity, independent of the personal interests of any particular director, officer, employee or shareholder.
>
> 6. The general counsel of a public corporation should have primary responsibility for assuring the implementation of an effective legal compliance system under the oversight of the board of directors.
>
> 7. Public corporations should adopt practices in which:
>
> a. The selection, retention, and compensation of the corporation's general counsel are approved by the board of directors.
>
> b. General counsel meets regularly and in executive session with a committee of independent directors to communicate concerns regarding legal compliance matters, including potential or ongoing material violations of law by, and breaches of fiduciary duty to, the corporation.

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212. *Independent Lawyer Report*, *supra* note 105, at 15-40.

213. *Final Report*, *supra* note 20, at 15.

214. *Id.* at 24-25.

215. *Id.* at 31-33. Tying general counsel compensation to earnings per share or other financial incentives, converges executive officers personal goals with the general counsel's goals of protecting the legal interest of the corporate entity. Unlike salary and bonuses, manipulation of financial disclosures can influence the price at which stock options are exercised and sold.

> c. All reporting relationships of internal and outside lawyers for a public corporation establish at the outset a direct line of communication with general counsel through which these lawyers are to inform the general counsel of material potential or ongoing violations of law by, and breaches of fiduciary duty to, the corporation.[216]

The ABA Corporate Governance guidelines underscore the important role of the general counsel in maintaining good corporate governance and ensuring independent advice to corporate management and boards. The Corporate Governance guidelines are a step forward in advising the general counsel on how to maintain independent legal advice. The Corporate Governance Resolution encourages regular meetings between the general counsel and independent directors to assure critical matters and fiduciary duty violations are reviewed by higher authorities.[217]

V. CONCLUSION: WHAT IS NEEDED FOR THE GENERAL COUNSEL?

General counsels need professional guidance responsive to the realties of corporate in-house practice.[218] Further review of Model Rules 1.7 and 1.8 is needed to assess the appropriate way to compensate general counsels and maintain independent legal advice to corporate clients.

In addition to embracing the ABA Corporate Governance Resolution, this article recommends that corporate boards consider the following governance measures: (1) set the general counsel compensation, including bonus; (2) reward and compensate the general counsel for managing the legal affairs of the company and not for reaching financial performance goals; and, (3) eliminate stock options from the total general counsel compensation.

By taking away evaluation and compensation authority from the chief executive officer, the general counsel is less inclined to worry about whether unpopular legal advice will result in reduced compensation.[219] Good corporate governance requires corporate gatekeepers' integrity to withstand the scrutiny of watchful regulators and corporate market constituencies.[220] The legal profession should not wait until faced with the

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216. *Id.* at 31-32.

217. *Id.* at 20-23.

218. Moore, *supra* note 123, at 545-47; Weaver, *supra* note 21 at 1050-51.

219. *See Findings and Recommendations*, *supra* note 69, at 10 (recommending that compensation committees take a more active role in evaluating executive compensation).

220. *See* Morgan, *supra* note 205, at 3 (explaining that the legal profession needs to continually adapt their ethics rules according to the changing dynamics of the world); Donaldson,

debacle suffered by the accounting industry. In light of recent general counsel conduct, continued discussion on additional ways to ensure that professional rules provide guidance to general counsels is needed.[221] Sarbanes-Oxley was enacted because Congress believed lawyers needed federal professional ethical standards. Why? Because it seems the current state bars and ABA professional rules were not enough to prevent general counsels from being indicted along with their clients.

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supra note 154 (explaining the SEC's policies as they concern four major SEC divisions: Enforcement, Investment Management, Market Regulation, and Corporation Finance).

221. Russell, *supra* note 16, at 545.