# The transformation of general counsel: setting the strategic legal agenda

**Constance E Bagley**
Yale University
**Mark D Roellig**
Massachusetts Mutual Life Insurance Company

## 1. Introduction

The evolving role of general counsel worldwide reflects the ever-expanding duties owed by businesses, not only to their home country but also to the countries in which they do business. Failure to comply with the law may lead to the demise of a firm and the imprisonment of its responsible managers. Enron and WorldCom collapsed in the wake of massive accounting fraud, and their executives were sentenced to prison.

More recently, lawmakers and regulators criticised banks for selling billions of dollars of faulty subprime mortgages and mortgage-backed securities. The investment bank Goldman Sachs paid $550 million to settle allegations by the US Securities and Exchange Commission that it had engaged in fraud when it failed to disclose that a counterparty that had a long position in derivative securities, whose value was based on the value of a basket of mortgage-backed securities, had hand-selected the underlying mortgages.[1] In September 2012, Bank of America Corporation agreed to pay $2.43 billion to settle a class action brought by investors who were allegedly misled about the bank's acquisition of Merrill Lynch & Company.[2] Less than a week later, the attorney general of New York State brought a civil action against JPMorgan Chase & Co, in which he alleged that its Bear Stearns unit had engaged in massive fraud, resulting in losses of over $22 billion.[3]

These scandals have not been limited to the United States. Standard Chartered Bank in the United Kingdom paid $340 million to settle claims that it broke US money-laundering laws.[4] In 2012, Barclays' chief executive officer (CEO) lost his job after regulators found that the bank had attempted to manipulate the London interbank offered rate (LIBOR), which is the reference rate for everything from student loans to commercial paper.[5] The bank paid $450 million in government fines.[6] Swiss bank UBS AG paid US, UK and Swiss regulators approximately $1.5

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1 Sewell Chan and Louise Story, *Goldman Pays $550 Million to Settle Fraud Case*, NY Times, July 16 2010, at A1.
2 Jean Eaglesham and Dan Fitzpatrick, *JPMorgan Sued on Mortgage Bonds*, Wall St J, October 2 2012, at A1.
3 *Ibid*.
4 Liz Rappaport, *Bank Settles Iran Money Case*, Wall St J, August 15 2012, at A1.
5 Josh Gallu, Howard Mustoe, Svenja O'Donnell and Roben Farzad, *The Libor Scandal Claims Its First CEO*, Bloomberg Bus Wk, July 3 2012, at A1.
6 Mark Scott, *Testifying in Britain, Volcker Questions Bank Innovation*, NY Times, October 18 2012, at B5.

billion in fines and penalties to settle similar claims.

The general counsel of a business firm:

> *… is sometimes viewed as the "ethics police person", who catches inappropriate activities and institutes corrective actions to bring the rule-breaker into compliance with corporate governance standards. The GC is also a key member of the committees that examine the adequacy of internal controls and compliance with regulatory rules. Thus, the GC occupies an important position for establishing and maintaining governance procedures within the firm.*[7]

General counsel also play a "multiplicity of [other] roles",[8] including manager of the legal department, legal advisor, transaction engineer,[9] negotiator, arbitrator, legal educator, crisis manager and strategic planner.[10] They are "the 'Swiss army knife' of the legal profession".[11]

In this chapter, we explore the evolving role of the general counsel in the United States and elsewhere. We then suggest ways that chief legal officers can not only keep their corporate client out of trouble, but also be strategic partners, actively helping the company to create and capture value and marshal resources while managing both legal and business risk. Indeed, we submit that general counsel can be more effective drivers of compliant corporate behaviour if they are strategic partners with the non-lawyer managers and encourage managers to take an active role in legal matters – that is, to be legally astute.

## 2. "Where were the lawyers?"

After the collapse of Enron and WorldCom, Judge Stanley Sporkin, former head of the Department of Enforcement at the Securities and Exchange Commission, famously asked: "Where were the lawyers?"[12] In an effort to ensure that lawyers protected public investors by playing a "gatekeeper role", Congress passed the Sarbanes-Oxley Act of 2002.[13] Among other things, the act required general counsel to report to the CEO certain material violations of law or breaches of fiduciary duty. The act further required general counsel to report such acts to the audit committee if he or she was not satisfied with the CEO's response. Although the SEC ultimately backed down on a more controversial proposal, which would have required general counsel to notify the SEC if a publicly traded company failed to correct misleading disclosures, regulators and scholars continued to debate exactly what responsibilities in-house lawyers owe the public.

Jagolinzer, Larcker and Taylor found that publicly traded firms that required the

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7 Alan D Jagolinzer, David F Larcker and Daniel J Taylor, *Corporate Governance and the Information Content of Insider Trades*, 49(5) J Accounting res 1249 (2011).

8 E Norman Veasey and Christine T DiGuglielmo, *The Tensions, Stresses, and Professional Responsibilities of the Lawyer for the Corporation*, 62 BUS L 1, 5 (2006).

9 Ronald J Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 Yale LJ 239 (1984).

10 Sarah Helene Duggin, *The Pivotal Role of the General Counsel in Promoting Corporate Integrity and Professional Responsibility*, 51 St Louis U LJ 989 (2007).

11 Omari Scott Simmons, *The Under-Examination of In-House Counsel*, 11 Transactions: Tenn J Bus L 145, 146 (2009).

12 Egon Guttman and Stanley Sporkin, *The Evolving Legal and Ethical Role of the Corporate Attorney After the Sarbanes-Oxley Act of 2002*, 52 AM U L REV 639, 641 (2003).

13 Sung Hui Kim, *The Banality of Fraud: Re-Situating the Inside Counsel as Gatekeeper*, 74 Fordham L Rev 983, 985-986 (2005).

general counsel to approve trades by insiders during trading blackout windows (which restrict insider trading immediately before earnings releases) had fewer atypical profitable trades based on non-public information than those who did not: "Thus, when given the authority, it appears the general counsel can effectively limit the extent to which corporate insiders use their private information to extract rents from shareholders".[14] In other words, notwithstanding the temptation "to seek to please the corporate officials with whom they deal rather than to focus on the long-term interest of their client, the corporation",[15] general counsel do not just 'rubber stamp' such trades. This study supports Gilson's assertion that in-house counsel may be the lawyers best positioned to act as private gatekeepers.[16]

The emphasis that the Sarbanes-Oxley Act put on the role of inside counsel as gatekeeper, or what Nelson and Nielsen call 'cop',[17] made it more difficult for the general counsel to be an active participant in creating value. A lawyer seen primarily as a 'cop' may be excluded from key conversations and decisions, on the assumption that "it is better to ask for forgiveness than for permission". Unfortunately, the later a lawyer is brought into the planning of a transaction, the more likely it is that the lawyer will have to advise "no". Business managers may anticipate this, and provide counsel with a biased set of facts in hopes of improving the likelihood of a 'yes' answer. Under either scenario, proceeding with the initial plan may not be the best approach for the enterprise.

This is why, as we discuss later in the chapter, legally astute top management teams take a proactive approach to legal matters. They bring counsel in early to assist not only in assessing legal risk but also in creating a strategy and a plan of execution that maximises realisable value while eliminating any unnecessary legal or business risks. Each member accepts responsibility for the ethical and legal conduct of business as well as for the firm's overall economic success. When strategically astute lawyers and legally astute non-lawyers work together, they are more likely to develop workable solutions than either the lawyers or the business managers acting alone.

## 3. A brief history of the general counsel transformation in the United States

The role of general counsel within large US corporations has evolved considerably from the late 19th century to the present, undergoing both rises and falls in its power and prominence. Today, the position is one of great prestige. (We call this the 'general counsel transformation'.) In-house counsel have not been held in such high esteem since the early 20th century.

Before the 1930s, general counsel served both legal and business functions, "were held in high repute", and "their sage counsel was regularly sought" by corporate management.[18] The position's high remuneration levels further emphasised this high

14 *Ibid*.

15 American Bar Association, Recommendations of the American Bar Association Task Force on Corporate Responsibility (March 31 2003), available at www.abanet.org/media/corpgovpdf.

16 Ronald J Gilson, *The Devolution of the Legal Profession: A Demand Side Perspective*, 49 Md L Rev 869, 915 (1990).

17 Robert Nelson and Laura Beth Nielsen, *Cops, Counsel, and Entrepreneurs: Constructing the Role of Inside Counsel in Large Corporations*, 34 Law & Soc'y Rev 457 (2000).

18 Carl D Liggio, Sr, *A Look at the Role of Corporate Counsel: Back to the Future—Or Is It the Past*?, 44 Ariz L Rev 621, 621 (2002).

status: counsel received roughly 65% of the CEO's salary and often were among the corporation's three highest paid officers.[19] For example, in post-Civil War America, general counsel positions at railroad companies were considered the most prestigious within the legal profession, attracting even federal judges.[20]

However, from the 1940s, there was a steady decline in the power and prominence of the general counsel position due to the rise of large outside law firms serving corporations' increasingly complex legal needs.[21] General counsel evolved into a "relatively minor management figure, stereotypically, a lawyer from the corporation's principal outside law firm who had not quite made the grade as partner".[22] The position handled "corporate housekeeping" matters, and acted as liaison to the outside legal firm.[23] Further contributing to the position's decline was the rise in status of those with master's degrees in business administration (MBA) (the new "wunderkinds of the business community").[24]

The high costs associated with switching between firms[25] gave outside counsel substantial bargaining power against their corporate clientele.[26] Because elite law firms were not able or willing to adjust their fee structures, corporations began to seek other, more favourable avenues to satisfy their legal needs, ultimately substituting inside counsel for outside counsel.[27] John Coffee explained:

> *The participant in this drama who gained the most from this transition was the in-house general counsel, who now became as much a general manager of legal services as an actual counselor to management. For his or her own self-interested reasons, the general counsel typically did not want competition from outside counsel. He or she wanted to be the primary conduit of legal advice to management and hence sought to discourage any long-term, continuing relationship between senior management and outside counsel. As much from this reason as to encourage price competition, the in-house counsel moved legal business around, thereby assuring his or her own monopolistic position as the supplier of legal advice to senior management. What shifted then was not the relative number of insider versus outside counsel, but the balance of power between them.*[28]

Robert Rosen called this shift the inside counsel's "age of enlightenment".[29] As he explained: "No longer lacking resolution and courage, inside counsel exercise their own powers with advice from, but not at the direction of, outside counsel".[30]

The American Corporate Counsel Association was established in 1980.[31] It was

19 *Ibid.*
20 Debora A DeMott, *The Discrete Roles of General Counsel*, 74 Fordham L Rev 955, 958-959 (2005).
21 *Ibid.*
22 Abram Chayes and Antonia H Chayes, *Corporate Counsel and the Elite Law Firm*, 37 Stan L Rev 277, 277 (1985).
23 *Ibid.*
24 Liggio, note 18 above, at 621.
25 Gilson, note 16 above, at 915.
26 Robert Eli Rosen, *The Inside Counsel Movement, Professional Judgment and Organizational Representation*, 64 IND LJ 479, 508-509 (1989).
27 *Ibid.*, at 505.
28 John C Coffee Jr, *Gatekeepers: The Professions And Corporate And Corporate Governance* 224 (2006).
29 Rosen, note 26 above, at 488.
30 *Ibid.*
31 Chayes and Chayes, note 22 above, at 514.

"expressly designed to create a new identity for the lawyers formerly known as 'house counsel'".[32] By the 1980s, general counsel performed increasingly diverse and nuanced roles:

> *They managed and reviewed the legal services provided to corporate clients by outside counsel; they regularly supplied routine legal services and, on some occasions, directly handled complex transactions and even litigation; they counselled clients and their constituents on regulatory requirements; and they created compliance programs.*[33]

According to the association, general counsel should:

- maintain a broader awareness of 'big picture' implications;
- manage an unfiltered flow of information throughout the corporation;
- provide frank and candid counsel to the CEO; and
- espouse a risk assessments approach.[34]

Perhaps the best known example of the high-status general counsel was General Electric's Benjamin Heineman, Jr. A former managing partner at the prestigious law firm Sidley & Austin, Heineman served as general counsel of General Electric from 1989 until 2006.[35] He built within General Electric an internal team of 1,000 lawyers, which in many respects mirrored the experts and specialists found in a top outside firm. Today, the general counsel of a major corporation in the United States is likely to be a former partner of a prestigious outside firm (eg, Dan Cooperman was a partner at Bingham McCutchen before becoming general counsel of Oracle then Apple) or a lawyer of a comparable calibre (eg, Paul Dacier, the general counsel at EMC Corporation, is the incoming president of the Boston Bar Association). As the type of work done by in-house departments became increasingly sophisticated and high profile, the status of in-house lawyers further increased.

This new breed of general counsel reduced the overall legal costs and fees paid to outside firms and expanded resources for the in-house legal function by stressing the need to introduce price competition to keep down legal costs. They actively managed the enterprise's overall legal function, including deciding what work to do in-house and by whom (eg, by using internal non-attorney professionals wherever possible), questioning costs (such as having junior associates accompany a partner at depositions), and putting work out to bid among a variety of firms or alternative legal service providers.

Although the shift did reduce legal costs and fees, it had another effect that has remained largely unexamined in the literature. By setting firms against each other, general counsel eliminated what had been strong ties between executives and directors in the corporation and the firm's outside counsel. Some general counsel go

32 David B Wilkins, *Is the In-House Counsel Movement Going Global? A Preliminary Assessment of the Role of Internal Counsel in Emerging Economies (Symposium: The Changing Role and Nature of In-House and General Counsel)*, 251 Wis L Rev 251, 277 (2012).

33 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, 1061-1062 (1997).

34 Constance E Bagley, *Winning legally: How managers can use the law to create value, marshal resources, and manage risk* 232 (2005).

35 David B Wilkins, *Team of Rivals? Toward a New Model of the Corporate Attorney-Client Relationship*, 78 Fordham L Rev 2067, 2081 (2010).

so far as to insist that one of their lawyers is involved in any conversation between an outside lawyer and a member of the management team. The insertion of in-house counsel between managers and the firm's outside lawyers has had several effects. First, to the extent that mixed questions of business and law are discussed with the general counsel, the outside lawyer may lose some of the nuance that would be picked up on if the communication was more direct. Perhaps more importantly, the distribution of a corporation's work over a variety of outside law firms eliminated the presence of an individual external lawyer capable of acting as a trusted adviser or consigliere to the corporation.

Historically, the senior partner in the outside firm that did most of the corporation's work served as the consigliere. That partner often attended all board meetings and established professional and social ties with the top management team. As a result, that lawyer understood the broad range of business activities with which the firm was engaged and often had a better sense of when a particular transaction might create undue financial or reputational risks than a lawyer brought in to handle a one-off matter. The final effect of this process of putting out legal work for bid was that, over time, the provision of legal services became more of a commodity than a trusted relationship. This is what happened in the accounting world when, before the Sarbanes-Oxley Act, companies paid relatively low fees for their audits, prompting the big accounting firms to augment their audit income with higher-priced consulting services. Reducing the role of outside counsel to a commodity gave them less incentive to develop firm-specific knowledge about their corporate clients.

In addition, the shift in power to in-house counsel prompted concerns that general counsel were becoming overly susceptible to forces that decreased independence. Nelson and Nielsen reported increased entrepreneurialism among modern lawyers, with:

> *… corporate counsel … adapt[ing] their images and lawyering styles to the prerogatives of contemporary management. Accordingly, inside lawyers limit their gatekeeping functions, emphasize their dedication to managerial objectives, and defer to management's judgments about legal risk.*[36]

Donald Langevoort argued that general counsel became too "comfortable" in their roles and may "too readily [have engaged in] … a process of collective rationalization" where "objectivity [or cognitive independence] is predictably diminished".[37] This comfort level and lack of objectivity may cause a corporation to assume unacceptable legal risks,[38] as arguably happened at Enron, Arthur Andersen, Google, Symbol Technologies, Rite Aid, Inso, Warnaco, Computer Associates International, Gemstar-TV Guide and Tyco.[39] Responding to many instances of blatant illegality, Congress enacted the Sarbanes-Oxley Act, which "essentially deputized a public corporation's CLO [chief legal officer] as a gatekeeper of … national securities markets".[40]

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36 Nelson and Nielsen, note 17 above, at 457.

37 Donald C Langevoort, *Getting (Too) Comfortable: In-house Lawyers, Enterprise Risk, and the Financial Crisis*, 2012 WIS L REV 493, 495 (2012).

38 *Ibid.*

39 Kim, note 13 above.

40 *Ibid.*