



Michael C. Ross

# Avoiding In-House Conflicts

By Michael C. Ross

In the aftermath of the recent corporate scandals, investigations, criminal trials of senior management and settlements of shareholder class actions, one question often heard is, "Where were the lawyers?" The media, government, class action bar, judges, juries and members of the public have high expectations for lawyers when it comes to spotting legal problems and doing something about them.

The Sarbanes-Oxley Act of 2002 revised New York Stock Exchange rules and, consequently, graders of corporate governance are all focused on independence and accountability. In this environment, it is more important than ever that in-house counsel identify and carefully manage actual and potential conflicts of interest.

Below are some examples of the sort of conflicts that regularly confront in-house counsel.

## Conflicting Interests among Senior Executives

There are often situations in which an in-house attorney is asked to advise a senior executive about matters in which his or her personal interest conflicts directly with the interests of the corporation. ABA Model Rule 1.13 states that the attorney's client is the corporation and not any of its individual officers, directors or employees. Although that principle is simple enough, the practical management of the conflict may be difficult.

A common context is the executive's employment relationship with the corporation, i.e., his or her employment agreement, retirement, health or severance benefits, purchase, or sale of company securities. The in-house attorney often perceives, with some justification, a great deal of pressure to satisfy the desires and protect the interests of the senior executive. It is often tempting to rationalize that the conflict is relatively minor, the potential conflict is somewhat remote or that no one will know or be hurt if the in-house attorney gives legal advice to a senior executive. There is also the possibility that good advice may result in a salary raise, higher bonus or more stock options.

Although in-house counsel must be practi-

cal, they must also be circumspect about executives' conflicts of interest. Small conflicts often lead to larger ones. Remote possibilities have a way of quickly becoming reality. No action or omission by an attorney (or for that matter a senior executive) should ever be taken based on the notion that no one will know or be hurt. Attorneys must first and foremost analyze issues from the company's perspective. In-house counsel should make it a habit to phrase advice in terms of the company's interests and, when necessary, politely remind senior executives that they are not permitted under applicable ethics rules to give legal advice that might be construed as inconsistent with the company's interests.

## Non-Conflicting Personal Interests among Senior Executives

Another common occurrence is the request by senior executives for free legal advice regarding strictly personal matters unrelated to the company. Work performed by in-house counsel is a corporate asset, paid for out of corporate funds. Even if there is no conflict of interest between the executive and the company, in-house counsel should not be misappropriated for personal use.

Identifying the problem and the governing principle is only the first step. The more important issue is how to respond, for example, to a CEO who is asking for personal legal advice. In some cases, it may be easy to dodge the request by pleading lack of expertise. This may work if your CEO is asking about estate planning, family law or traffic court. It will be more difficult if he or she asks you about issues relating to the purchase of a vacation home and you are the company's real estate attorney, or if the CEO comes to you with a question about personal income tax issues and you are the company's tax counsel.

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In-house counsel can avoid the problem by explaining that he or she has no professional liability insurance covering personal representations. If the executive gives assurances that he or she would never sue, in-house counsel may have no choice but to tackle the issue head on. An argument that might be persuasive is that if all the senior executives were free to use in-house counsel for personal legal matters, the lawyers would have little time for company matters. This provides the basis for what in-house counsel need, a company policy that prohibits personal use of in-house counsel.

**Indirect and Potential Management Conflicts**

Some of the most difficult issues arise when senior executives (or members of their immediate family) have financial interests in enterprises that do business with the company, such as suppliers, customers or affiliates.

The most obvious cases are those in which the senior executive is directly involved in decision-making, such as operations, marketing or purchasing. Somewhat less obvious are situations in which the decisions are made by employees who report directly or indirectly to the senior executive who has the conflicting financial interest. Is it realistic to expect completely independent judgment from subordinates? If the executive with the conflicting financial interest is the CEO, another senior management official or a member of the board of directors, even the general counsel, may feel pressure not to adversely affect the financial interests of that executive.

The preferred solution is avoidance of conflicts in the first place. But because zero tolerance is often impractical, procedures must be established to protect those who are empowered to make independent judgment from the adverse conse-

quences of making decisions contrary to the financial interests of the conflicted executives. In addition, those independent decision-makers should have the authority to obtain legal advice and retain experts in the subject affected by the conflict because, in many cases, the company's expertise will reside with the conflicted executive or in his or her department.

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**Law Firms and Other Suppliers of Legal Services**

In-house counsel generally do not have financial interests in outside law firms. But an attorney who is on a leave of absence from a firm may have a financial interest in his or her firm through a continuing interest in a retirement or profit-sharing plan. Attorneys could have an interest in a supplier of other legal services, such as photocopying, electronic billing or consulting. These financial conflicts should be subject to the company's procedures for managing conflicts. There is no rational basis for exempting in-house attorneys.

Many companies have codes of business conduct that prohibit or severely limit employees' acceptance of gifts, gratuities and excess entertainment from suppliers of goods or services. Nonetheless, many law firms continue to devote significant resources to entertaining existing

and prospective clients. It is common practice for outside attorneys, for example, to offer in-house lawyers tickets to sporting and cultural events. Outside lawyers regularly entertain in-house counsel at such events or on the golf course or at fancy restaurants.

Is it realistic to expect that in-house attorneys will be immune from the influence that outside counsel seeks to obtain by these means? Even if all in-house counsel were able to conduct the business of selecting counsel, negotiating rates, demanding discounts and firing outside counsel as if the perquisites had not been given, appearances are important. It is incumbent upon members of the legal department to set the best example for employees throughout the company. It is difficult for management to expect company-wide compliance if in-house lawyers are not abiding by the letter and spirit of the code of conduct.

**Lawyers Acting in Business Roles**

One of the benefits of serving as in-house counsel is the opportunity to be involved in making business decisions rather than merely giving legal advice. Many attorneys who manage transactions or disputes routinely make business judgments on behalf of the corporation. The issue here is who, if anyone, will provide legal advice about the business decisions made by the lawyers.

One choice is an in-house attorney who either reports to the decision-maker or works in the same department. The capability to review such business decisions may be limited by the legal department's resources. The general counsel or another senior attorney may lack the depth of expertise in the subject matter of the decision. In addition, a subordinate attorney may be naturally reluctant to criticize a more senior attorney's judgment.

The other option is to turn to outside counsel. Although this means

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additional expense, it may well be worth it. But the potential for conflict of interest still lingers because a firm hired by the general counsel might be reluctant to criticize his or her judgment for fear of losing additional business.

These potential difficulties do not mean that a general counsel or other senior in-house lawyers should refrain from making business decisions. They do mean that when in-house lawyers are acting in a business capacity, they should be aware of that role and be prepared to have their decisions reviewed by other counsel. More important, inside or outside counsel who give advice about the business judgments

of inside counsel must have the independence and resources to do so.

**Conclusion**

Identification and management of conflicts of interest are critically important these days. In-house counsel can help management avoid the pitfalls that have plagued companies that have become the poster children of corporate scandals. Just as important is the example that in-house counsel set for the entire enterprise. ♦

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