The company moral compass

Gatekeeping can be a tough gig, but corporate counsel has to do it

By Paul Paton

Former Hollinger International executive and in-house counsel Mark Kipnis (centre) leaves the federal building in Chicago, after his racketeering and fraud trial in 2007.

It's a tough time to be a corporate counsel.

It's bad enough that the financial meltdown has left shareholders desperate, executives bereft and the litigation floodgates about to open. Serving as a corporation's "moral compass" has always meant balancing a complex array of strategic and legal challenges from various internal and external constituencies—boards of directors, senior management, shareholders and stakeholders—and those stakes are higher than ever.

But the pressures on corporate counsel since Enron go much further than that—they're in the regulators' sights and failing to act as the "gatekeepers" that legislators and regulators expect can lead to devastating personal and professional consequences.

Take the cautionary tale of Mark Kipnis, former corporate counsel at Hollinger International. Responsible for documenting and closing each one of the contentious non-competition agreements at the centre of the Conrad Black trial in Chicago last year, Kipnis didn't benefit financially from the transactions himself. While non-competition payments that Black and co-defendant Jack Boultbee were found to have misdirected from shareholders into their own pockets ran into the millions, Kipnis received a $150,000 bonus for what some might see as simply doing his job in an organization that a Hollinger special committee report labeled a "corporate kleptocracy."

But a jury on the South Side of Chicago thought otherwise and convicted Kipnis on criminal charges, arguably for simply following senior management's instructions about the contentious deals. As one juror reportedly put it: "A lot of us felt very bad for Kipnis...but he was right there in the middle of it." Being in the middle of it—and failing to stop it—can lead to professional discipline and possibly prison time.

Lawyers—including corporate counsel—have always been subject to discipline by the profession's regulators. The Canadian Bar Association's *Code of Professional Conduct* and provincial law society rules carve out no exemption for in-house counsel and have very few rules specifically directed towards lawyers in organizations.

An "up the ladder" reporting obligation was added in Canada only after the *Sarbanes-Oxley Act*, dubbed SOX by many, passed in 2002. In it, the U.S. Congress tasked the U.S. Securities and Exchange Commission (SEC) with responsibility for regulating attorney conduct and directed the SEC to add a requirement for lawyers to report instances of malfeasance in particular circumstances

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"up the ladder" to the highest echelons within an organization. At one point, SEC staff proposed going further, directing lawyers to "report out" and engage in "noisy withdrawal" if the organization didn't take appropriate steps to remedy the situation when reported, but they backed off in the face of intense protests from the American Bar Association (ABA) and the U.S. corporate bar.

But the ABA moved an important and necessary step further than Canadian legal regulators. Under pressure from its task force on corporate responsibility and after two previous attempts in 1983 and 2000, the ABA adopted a "crime-fraud" exception to confidentiality rules, permitting (but not requiring) an attorney to disclose information about client fraud involving grave future or ongoing harm. This change provides corporate counsel in the U.S. with an important tool to deal with exceptional circumstances. Their Canadian counterparts face similar pressures, without the benefit of the same ability to respond.

It would be one thing if the Kipnis case were an isolated incident. But it's not. For corporate counsel on both sides of the border, the real pressures now come from a newfound vigilance on the part of the SEC. In a March 2008 speech, the director of the SEC's Division of Enforcement boasted that in the prior five years, the SEC had "sued 125 lawyers, nearly half of whom were general counsels."

Contrast that with the period between 1998 to 2001, before Enron and SOX. The SEC brought 49 cases against lawyers during that time frame, most of which involved insider trading. The number and nature of enforcement actions has changed dramatically, confirming fears that the SEC could use its newfound SOX powers to hold all lawyers, and corporate counsel in particular, more accountable as "gatekeepers" responsible for policing client actions, not just advising on them.

A former SEC enforcement director signaled this new trend in a 2004 speech, explaining that the SEC had "seen too many examples of lawyers who twisted themselves into pretzels to accommodate the wishes of company management and failed to insist that the company comply with the law."

But — as corporate counsel will certainly appreciate — sometimes that's much easier said than done. The recent 125 SEC cases include what might be labeled as low-hanging fruit: cases of outright fraud, looting of corporate assets, falsified disclosure and insider trading. Despite arguments about the legitimacy of stock-option backdating, most of these cases won't strike many as especially problematic or troubling. If anything, they are clear illustrations of instances where the public — and the profession — have a right to expect that these lawyers will be held to account as key players responsible for maintaining the integrity of the capital markets.

But what about cases that are close to the line? Some might argue that someone like Kipnis was simply doing his job in papering deals that other professional advisors — lawyers and accountants alike — had sanctioned and boards or committees had approved. The pressures to conform — to maintain open lines of communication with management essential for a corporate counsel to do their job and executives to whom the general counsel might report — are both understandable and enormous.

The signal being sent by the SEC generally and in the Kipnis conviction in particular, however, is that the orthodox view about the role of the general counsel as legal advisor is no longer good enough. The *Wilder v. Ontario (Securities Commission)*, [2001] O.J. No. 1017 decision in 2000 affirmed the right of the Ontario Securities Commission to regulate the conduct of lawyers appearing before it, and so similar enforcement vigilance in Canada might not be that far away.

The basic question of "who is the client?" is increasingly complex and critical as corporate counsel both serve as advisors to the corporation and attempt to negotiate new expectations of what duties a gatekeeper is supposed to owe to both regulators and the public. The tools available in the U.S. are a help, but alone they are not enough. The reality for corporate counsel has always been that saying no to corporate officers is a high stakes matter. Unlike their law firm counterparts, losing your client translates immediately and harshly to a loss of status and income.

But those consequences pale when measured against the direction the SEC has headed — not content simply to let lawyers be disciplined by the profession's traditional means, aggressive prosecution is leading to significant personal and professional consequences well beyond losing a job.

The answer for corporate counsel may lie in a New York City Bar Association's Task Force November 2006 report on the "Lawyer's Role in Corporate Governance": "[I]t may take genuine professional courage to provide unwelcome advice and stick to it."

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That language may offer cold comfort, but for corporate counsel in the post-Enron era, professional courage — and a healthy eye on the consequences for failing to maintain it — is essential, now more than ever before. An appreciation of these challenges by regulators, and by the rest of the bar, would also go a long way towards providing corporate counsel the strength needed to chart these dangerous waters.

Gatekeeping moral compasses with "professional courage" — serving as corporate counsel is a tall order these days. END

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