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The GC's Greatest Challenge: Resolving the Partner-Guardian Tension

Law Department Management

CHEAT SHEET

- ***Aligning C-suite and legal objectives.*** Optimally, the CEO explicitly issues authority to the GC to manage a broad spectrum of ethical issues beyond mere compliance.
- ***Changing attitudes.*** The myth of legal as the “Department of No” still persists in some boardrooms, and it’s the GC’s job to advocate for themselves and their legal department.
- ***Freedom at all costs.*** Independent and credible GCs must resist perverse incentives and the influence of the CEO or the board over legal recommendations.
- ***The revolution rumbles on.*** As the business and legal functions converge, the critical fusion of the partner and guardian roles in the business will continue to gain support.

Over the last 30 years, there has been an inside counsel revolution of increasing scope and power that has transformed both business and law in two important ways. Inside the corporation, the general counsel has often replaced the law firm senior partner as the primary counselor for the CEO and board of directors on core issues like performance, compliance, ethics, risk, governance, and citizenship. The GC’s stature is now comparable to the chief financial officer because the health of the corporation requires that it navigate complex and fast-changing law, regulation, litigation, public policy, politics, media, and interest group pressures across the globe. Outside the corporation, the role of the general counsel has also grown in importance with a significant shift in power from outside law firms to inside law departments over both matters and money. As a result of both trends, the

expertise, quality, breadth, power, and compensation of the general counsel and inside counsel have significantly increased.

Excerpted from Heineman's newly published book, "The Inside Council Revolution: Resolving the Partner-Guardian Tension" (Ankerwycke 2016).

This revolution is built on two aspirational but practical roles of the general counsel and inside lawyers. First, the general counsel must be a lawyer-statesperson who is an outstanding technical expert, a wise counselor, and an accountable leader. She has a major role assisting the corporation achieve its fundamental mission: the fusion of high performance with high integrity and sound risk management. For the lawyer-statesperson, the first question is: "Is it legal?" But the ultimate question is: "Is it right?" As a lawyer-statesperson, the general counsel must engage in robust debate on all major corporate initiatives about what are the "ends" of that action, not just about "the means" for carrying it out; about "purpose" not just "process;" about consequences, not just acts. The general counsel is well positioned as counselor and leader to introduce a dose of "constructive challenge" to such discussions about "what is right" on key ethical duties to the corporation, to stakeholders, to the rule of law, and to society.

But to function effectively as a lawyer-statesperson, the general counsel must assume a second aspirational position by meeting the greatest challenge for inside lawyers: She must reconcile the dual — and at times conflicting — roles of being both a partner to the business leaders and a guardian of the corporation's integrity and reputation.

The tension

General counsel have failed as guardians. In the 21st century's first great wave of scandals, beginning with the collapse of Enron and WorldCom, the recurring question was, "Where were the lawyers?" In-house counsel were excluded from key decisions; failed to ask probing questions; and rubber-stamped improper business decisions. But, compared to CFOs, they generally escaped formal sanctions. In subsequent options backdating investigations, GCs were once again squarely in the middle of corporate improprieties — and in the line of fire. Indictments, settlements, pleas, and convictions of inside lawyers resulted, including SEC sanctions for the GCs of both Apple and Google. Then, the Hewlett-Packard GC resigned after taking the Fifth Amendment at a Congressional hearing because the HP board chair had pressured her to use unethical and illegal "pretexting" to investigate leaks from its board of directors, secretly obtaining director phone records through subterfuge and misrepresentations.

The Enron debacle, the back-dating scandal, and the HP "pretexting" case are just part of a burgeoning parade of misdeeds where inside lawyers, in their eagerness to "partner" with business leaders and appease them, utterly failed in their responsibilities as guardians. They have been found culpable in criminal investigations, in SEC inquiries, in other enforcement actions, and in private civil actions because they were supine in the face of business pressure and complicit in improper acts. To critics, exemplified by Professor John Coffee in his book, "Gatekeepers: The Professions and Corporate Governance," the unceasing stream of major corporate scandals demonstrates that inside lawyers will inevitably be weak and compromised: They simply lack "independence," because they are subject to "pressure and reprisals" from business leaders.

By contrast, the New York City Bar Association "Report of the Task Force on the Lawyer's Role in Corporate Governance," issued in November 2006, states that "the role of the general counsel of a public company is central to an effective system of corporate governance." (Disclosure: I was one of

many people interviewed and cited by the Task Force.) The Task Force used corporate scandals, not to argue that general counsel were always compromised, but rather to argue that these events demonstrated the need for strong internal disciplines and for a strong general counsel to help integrate those regimens into business operations. Similarly, the former Chief Justice of the Delaware Supreme Court, in a recent book, has argued powerfully for the general counsel's essential role as a guardian of a corporation's integrity, endorsing the partner-guardian fusion I have long advanced. Many other voices maintain that a strong guardian role for the general counsel is both desirable and feasible.

I do not believe that the choice for general counsel and inside lawyers is to go native as a "yea-sayer" for the business side and be legally or ethically compromised, or to be an inveterate "nay-sayer" excluded from key corporate discussions, decisions, and actions. Indeed, I think being both an effective partner of business leaders and respected guardian of the corporation is critical to the performance of each role. I deeply believe that this fusion is possible. But, certain key conditions inside the company must exist and very real obstacles must be overcome for this to occur.

The fusion

In the optimal situation, the CEO and board of directors *explicitly* authorize the GC to help create value, protect integrity, and manage risk as expert, counselor, and leader on core issues: business, law, ethics, reputation, communications, risk, public policy, governance, and corporate citizenship. This authorization occurs in the following ways.

As partner-guardian, the general counsel *must have a deep and broad understanding of the corporation's business activities in the context of the broader geopolitical environment.* Increasingly, CEOs and boards of directors are seeking GCs with business knowledge and acumen relating to such issues as finance, technology, products, markets, geographies, and competitors.

As partner-guardian and as a senior officer of the corporation, the general counsel *must be fully engaged in the high level and high priority planning and decisions facing the company* both in the near and longer term to obtain that understanding. The general counsel should have an immutable standing invitation to attend the key business meetings that occur on a regular rhythm at the CEO level: annual strategic and budget reviews of business units; regular (often quarterly) updates with senior business leaders; regular meetings of the corporate executive committee to review top company priorities; and key decision meetings on discrete issues.

As partner-guardian, in *planning and decision meetings* with the CEO and top business leaders, the general counsel can *function both as a lawyer and as a business person.* As a lawyer, the GC is being a "partner-guardian" in finding effective, lawful ways to achieve legitimate corporate goals. But, as a smart, informed generalist, the general counsel can also be a "partner" by bringing to discussion and debate other "wise counselor" perspectives — from ethical and reputational issues to broader corporate strategy and business issues (e.g., identification of risk, assessment of counter-party motives, or helping define the key trade-offs). The GC must, of course, know when she is crossing over from being a lawyer proffering legal advice to a broader business counseling role, giving up the attorney-client privilege and making her comments subject to private discovery or government inquiry.

As partner-guardian, the general counsel and inside lawyers *also play a vital role in implementing major strategic and operational objectives that create value and competitive advantage.* Indeed, properly analyzed, virtually every legal area in the corporation creates value and is vital to

commercial performance: e.g., outstanding due diligence, negotiating key deal terms, simplifying sales contracts, aiding product development, mitigating country risk, and achieving public policy objectives. As partner-guardian, the general counsel has a vital job in all corporate settings to help devise and then to implement measures to protect the corporation's integrity and manage its risk. It involves raising hard, uncomfortable issues in discrete settings. But, importantly, it involves playing a key role so that integrity and risk issues are systematically addressed and integrated into business processes that are owned by business leaders. The trust built up by the general counsel and inside lawyers as partners on business decisions and execution give them great credibility to work with executives as guardians and integrate integrity issues into business processes. As partner-guardian, the general counsel, along with the CEO and other senior officers, ultimately needs to *define the proper approach to checks and balances* in all aspects of corporate decision-making and corporate action — to find the right balance between creativity/innovation and risk assessment/risk mitigation.

The obstacles

There are many potential obstacles inside corporations that might undercut a seamless partner-guardian fusion for the general counsel and other inside lawyers. Business people may lack understanding about law and policy. Top execs or mid-level P&L leaders can hold antediluvian attitudes about lawyers (as "Dr. No's" or "just cost centers"). Negative group pressures may exist in decision meetings when the CEO is in a hurry and other senior officers want to curry the CEO's favor. More general group pressures may exist when GCs work for a single client and are socialized into a corporation's pure performance ethos (short term shareholder value). The GC can be caught in tense conflict if she feels constrained to advise the board, as representatives of the whole company, about an important disagreement with the CEO. The GC can fear the CEO: being fired, losing present or future financial benefits, being excluded from meetings, or being humiliated. The GC's guardian role can also be compromised due to conflicts of interest stemming from her compensation package which may stimulate improper acts to pump up stock price.

The partner/guardian conflict in small- and medium-sized companies

At virtually every presentation I have given on high performance with high integrity, and the lawyer-statesman and partner-guardian roles, I am admonished by the audience: "You worked for a mega-company with a huge balance sheet, but what should a smaller company do?" Here is my answer.

With respect to compliance with externally mandated formal rules, small- and medium-sized companies have the same obligation to obey the law as large companies. They must prioritize their compliance risks and spend more where the risks are higher. But they cannot ignore the law. A failure to be compliant can have two adverse consequences. First, if a small or medium-sized company takes a compliance torpedo amidship, it can sink when the matter is serious. A Siemens or a JP Morgan can seal the area, fix the engines, and sail on. A major compliance issue can send a small or medium-sized company to the bottom of the sea. Second, many small companies want a nice payday by selling themselves to big companies. But due diligence techniques of large acquirers on compliance issues have become more sophisticated. If the acquirer finds a problem, it may tell the target: "Drop the purchase price," or "Turn yourself in or deal is off," or simply "Sayonara." So, not addressing the compliance issues creates deal risk as well as enforcement risk for small- and medium-sized companies.

With respect to ethics, small- and medium-sized companies may not have the same discretionary resources as large companies. They will almost surely need to be more selective in deciding what

standards of conduct — beyond what the formal rules require — they can or will adopt. Just like larger companies, they will need a process for identifying ethical issues of great salience for their type of business. But the CEO, business leaders, and staff leaders, including the GC, will need to perform triage — deciding, for example, that a voluntary action protecting consumers is more important than a voluntary action protecting the environment. Their ethical actions — what is "right" in a voluntarily sense — may thus be of smaller scope. But, at the end of the day, people who run small businesses — and general counsel who work in them — have to look in the mirror and decide what kind of company they want to operate.

One of the great business school cases is about the Indian founder of Infosys, Narayana Murthy, who simply refused to pay a small bribe to get telephones installed so his new company could start operations. For months, employees in this promising start-up had to go outside the premises and use pay phones. Infosys lost orders. But Murthy wouldn't bend because he believed so strongly in doing business the right way. He is a wonderful example of looking in the mirror and deciding on integrity even at the cost of lost business (eventually he got the phones installed without the bribe).

Overcoming the obstacles

To obviate these problems, the general counsel needs key *personal qualities:* a strong character, a strong reputation outside the corporation, and a strong sense of identity. I consider the following character traits key. The general counsel must have a strong sense of *independence*. She must have the *courage* to speak out, even in pressured situations and even when she may be a lone voice in a group of powerful people. The GC must have *tact* in expressing her views and must act in a constructive manner that is firm but not offensive. Finally, she must have *credibility* that engenders trust so that her business superiors and peers believe, although they may disagree, that the GC is trying to do the right thing for the corporation — and for them.

In addition to these character traits, the *professional reputation* of the general counsel outside the company generates respect and enhances her capacity to function as partner-guardian inside the corporation. This professional reputation can exist because of prior positions either in the public sector or in private practice or in other inside counsel jobs. It can also obtain by and because of national expertise on issues (e.g., litigation, tax, trade, labor, and employment). Finally, in addition to character and professional reputation, the general counsel *needs to be explicit with her peers and her superiors about the core identity as partner-guardian* that she and other lawyers aspire to assume inside the corporation. The GC must not shy away from articulating her vision of her role in the company.

In addition to leveraging these personal qualities, the GC can overcome the obstacles to fusing the partner/guardian roles through alliances with peer staff leaders. The finance, human resources, compliance, and risk functions have the similar involvement in some or all of the corporation's core activities. They have partner-guardian responsibilities analogous to those of the legal department — and face similar obstacles to fusing the roles. Legal, finance, HR, compliance, and risk are essential elements of the company's nervous system. They connect, and signal to, all extremities of the corporate corpus on key issues of integrity and risk. If they can act in concert and support each other, the chances are greatly enhanced that these separate staffs functions can overcome the obstacles to the partner-guardian fusion each faces alone. The GC-CFO relationship is especially important because the first element of corporate integrity is adherence to formal rules legal and financial. The

integrity of a company has as its foundation on both the accuracy of its financials and on its compliance with law. Both GC and CFO must be jointly committed to performance in the right way. Close collaboration, coordination, and friendship among these staff leaders are critical aspects of real, effective corporate governance. But there is always a risk that the occupants of these critical positions — finance, compliance, risk, and HR — will be courtiers and sycophants, subservient to CEO whims.

The board of directors plays a critical role in overcoming the obstacles by making clear that its CEO selection process values high performance, high integrity, and sound risk management. The mission of the new chief executive and the company's top staff, including the GC, is to have a partner-guardian role. In addition, there are key aspects of the board-GC relationship that promote the partner-guardian fusion. Although the GC should not be on the board, she should be part of the board culture (committee meetings, events, dinners) and have personal relationships with individual board members. The board of directors should have oversight of both the hiring — and any firing — of the top staff officers, including the general counsel. This meaningful advisory role stems, of course, from the basic principle that the GCs' client is the corporation as embodied by the board of directors. The general counsel should report to the full board or to committees on key performance, integrity, and risk issues as part of regular board processes. But the general counsel *should meet alone with the board as a whole or with the Audit or Risk Committee at least two times per year* to raise privately any issues of concern or to answer any director questions. The board, not the GC, should establish this private meeting — just as the Audit Committee may meet alone with the CFO, the internal audit staff, and the external auditors — to avoid, or at least mitigate, erosion of the critical CEO trust in the GC. And the board should be intimately involved in setting GC compensation to ensure proper rewards for advancing integrity, risk management, and proper compensation recovery policies if the GC fails on that core set of issues.

The CEO

The CEO's explicit recognition and support of the dual partner and guardian roles for the general counsel and other top staff leaders is necessary, at the end of the day, to overcome the obstacles to their fusion. This requires complete integration of the GC into the affairs of the corporation, as described above. But this recognition is shown in the genuine attitude of the CEO and his relationship with the GC. The CEO must make clear to the company the deep belief that the general counsel and key inside lawyers are strongly motivated and highly effective in helping the CEO "win" in the company, the marketplace, and society, according to appropriate performance, integrity, and risk standards. The CEO must make clear to all that the GC should be neither a "yea-sayer" nor "nay-sayer," but a strong, independent, and courageous voice to speak out about the GC's vision of what is the right long-term, enlightened self-interest of the company. The complex elements of chemistry and trust that must exist between the CEO and the general counsel in support of the partner-guardian roles in a hard-charging global company are hard to describe and impossible to mandate. But, the hard guardian discussions about limitations and constraints in the present are made easier by business partnership accomplishments in the past.

Nonetheless, the greatest problem GCs face is the risk that a CEO will undermine the partner-guardian role. I strongly believe that being a GC is far better job today than being in a law firm. But law firms can "fire clients." GCs cannot "fire CEOs." CEOs have an endless capacity to take life miserable for GCs. To mitigate this risk, GCs can conduct some due diligence at the "front end" between being offered the job and accepting it. This is a period when a GC candidate can ask to meet with officers and directors and can talk privately with third parties who know the CEO and the corporation. Such diligence is not going to be perfect, but it is surely an important step to take before

saying “yes.” But, at the “back-end,” *GCs must know going in that they may have to resign to preserve their integrity, even if that means loss of a prestigious position and significant financial benefits.* With a good board/good CEO or a good board/bad CEO, the GC can often work out CEO problems or have a graceful exit due to board intervention. But with a bad board/bad CEO, GCs must look in the mirror and say “time to go.” They must truly confront the resignation possibility before they start, not just when bad things happen.

Prospects

Nonetheless, I am optimistic that the board and CEO attitudes about high performance with high integrity and about the lawyer-statesperson and partner-guardian roles can — and will — exist. This is so not because of nice theory, but because of hard necessity. The inside counsel revolution occurred, in part, as a reaction to the excesses and acquisitiveness of outside law firms. But the key driver was the dramatic increase in global commercial complexity and in related “business in society” issues that sophisticated inside lawyers can handle with speed and skill. Astute CEOs and boards know that successful performance that engenders trust depends importantly on navigating effectively and fairly myriad laws, regulations, investigations, enforcement, and public criticism. They know that a highly talented, broadly experienced, analytically rigorous, and consistently innovative general counsel — and an outstanding law department — are needed to deal in a systematic and rigorous way with the core issues of business strategy, value creation, culture, compliance, ethics, risk, governance, and citizenship.

Because these necessities, and the external pressures on corporations, are only going to increase, I believe that the inside counsel revolution — and support for the critical fusion of the partner and guardian roles — will continue to gain board and CEO adherents in companies of all sizes, both in in the United States and in the rest of the world.

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